OFFICE OF THE OMBUDSMAN

FORTIS ET LIBER

Province of Alberta

SPECIAL REPORT

The Role of the Provincial Government in the Regulation of The Principal Group of Companies

1989

REPORT OF THE OMBUDSMAN

PRINCIPAL GROUP INVESTIGATION

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GLOSSARY OF TERMS

AHL	Athabasca Holdings Ltd.
AIC	Associated Investors of Canada Ltd.
ASC	Alberta Securities Commission
BC	British Columbia
CBICA	Canadian and British Insurance Companies Act
CCA	(Department of) Consumer and Corporate Affairs
CDIC	Canadian Deposit Insurance Corporation
CSI	Collective Securities Inc.
CSL	Collective Securities Ltd.
CSV	Cash Surrender Value
E & E Report	Ernst and Ernst Report
EL&F	Estate Loan and Finance
FIC	First Investors Corporation Ltd.
ICA	Investment Contracts Act
PCL	Principal Consultants Ltd.
PGL	Principal Group Ltd.
PSML	Principal Securities Management Ltd.
PS&T	Principal Savings & Trust Company
TR	Transcript Code Investigation

OMBUDSMAN'S REPORT - PRINCIPAL GROUP INVESTIGATION

1. REASONS FOR INVESTIGATION

On June 30, 1987, a press release was issued by the Provincial Treasurer of Alberta, the Honourable Dick Johnston, confirming that First Investors Corporation Ltd. ("FIC") and Associated Investors of Canada Ltd. ("AIC"), subsidiaries of Principal Group Ltd. ("PGL") of Edmonton, Alberta had applied to and been granted an Order by the Court of Queen's Bench appointing Coopers & Lybrand as a Manager under the Companies Creditors Arrangement Act. This followed the cancellation of the registration which had allowed the two companies to raise money from investors pursuant to the Alberta Investment Contracts Act.

The press release is attached as **Exhibit 1.**

FIC and AIC were incorporated under the Alberta Business Corporations Act and were registered and transacted business in Alberta under the authority of the Alberta Investment Contracts Act ("ICA"). They offered term certificates, annuities and instalment accumulation savings plans. They were not members of the Canada Deposit Insurance Corporation ("CDIC") and therefore investors in their products were not provided with insurance against loss. The collapse of these companies directly affected more than 66,000 customers, over 20,000 being residents of Alberta.

FIC and AIC were subsidiaries of PGL which included trust and other investment companies, all forming part of a larger group of companies under the control of Donald Cormie.

On August 10, 1987, PGL made a voluntary assignment into bankruptcy, appointing Collins Barrow Ltd. as Trustee.

On the same day, the Director of Trust Companies of the Province of Alberta appointed B.I. Robertson & Associates Ltd. as Receiver for the affairs of Principal Savings and Trust Company ("PS&T"), another of the main subsidiaries of PGL, which had functioned as the banking outlet for all PGL group customers.

On August 13, 1987, Court of Queen's Bench Justice Ronald Berger appointed Mr. William E. Code, Q.C., as Inspector to conduct an investigation into the failure of FIC and AIC pursuant to Section 224 of the Business Corporations Act.

Subsequent to the collapse of PGL, numerous complaints were received by my office alleging that improper regulatory and government action led to the collapse and subsequent losses.

During 1987, 1988 and 1989, 237 complaints were received by my office. An analysis of the nature of those complaints is attached as **Exhibit 2**.

On October 14, 1987, the Honourable James D. Horsman, on behalf of the Honourable Dick Johnston, after discussion with me, issued a Ministerial Order requesting me to investigate and conduct the broadest possible review of the regulatory process and administration of Regulation as it applied to the Principal Group of Companies. Copies of correspondence relating to the Ministerial Order are attached as **Exhibit 3**.

2. ISSUES INVESTIGATED

After analysis of the complaints received in my office, careful consideration of the request of the Provincial Treasurer, and meetings with concerned individuals and groups, I have directed my investigation to the following issues:

A. THE REGULATION OF FIC AND AIC BY ANY DEPARTMENT OR OFFICIAL OF THE GOVERNMENT OF ALBERTA.

In this regard, I considered:

(1) Whether there was any failure in the regulatory process;

(2) If so, whether that failure contributed to any losses incurred by any person or group including:

(a) Investment contract holders,

(b) Employees of those companies (For example, I have received a number of complaints from salesmen),

(c) The owners of those companies, as a result of their licence to operate being removed;

(3) If regulatory failure had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(4) Whether the regime of regulation, either the statute and regulations, or the policies and procedures developed

in administration of them, or both, were faulty and should be amended.

B. MONITORING OF THE ACTIVITIES OF PGL IN RAISING CAPITAL BY ISSUANCE OF PROMISSORY NOTES PURSUANT TO CERTAIN STATUTORY EXEMPTIONS FROM THE USUAL REQUIREMENTS OF THE SECURITIES ACT OF ALBERTA BY ANY DEPARTMENT OR OFFICIAL OF THE GOVERNMENT OF ALBERTA.

In this regard, I considered:

(1) Whether the activities of that company, combined with the knowledge of various officials and departments of the government about the affairs of it and of other member companies of the PGL group, should have caused the relevant departments or officials to limit or remove access to the exempt market by PGL;

(2) If so, whether failure to do so contributed to any losses incurred by any person or group, mainly, in this case, the noteholders;

(3) If such failure to act had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(4) Whether the exemptions in the Securities Act allowing such capital raising should be amended or modified, or whether policies or procedures to monitor such capital raising should be developed.

C. THE REGULATION OF PRINCIPAL SAVINGS AND TRUST COMPANY BY ANY DEPARTMENT OR OFFICIAL OF THE GOVERNMENT OF ALBERTA.

In this regard, I considered:

(1) Whether there was any failure in the regulatory process;

(2) If so, whether that failure contributed to any losses incurred by any person or group, including:

  (a) Depositors,

  (b) Employees,

  (c) The owners of the company, as a result of the company being taken over and wound up;

(3) If regulatory failure had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(4) Whether the regime of regulation, either the statute and regulations, or the policies and procedures developed in administration of them, or both, were faulty and should be amended.

3. METHOD OF INVESTIGATION

William E. Code commenced the public portion of his investigation on October 14, 1987, after conducting an extensive document search that included government documentation relevant to his inquiry into the failure of FIC and AIC. As well, over the one and one half year span of his investigation, he canvassed the evidence, in public, of many of the witnesses relevant to the involvement of the Government of Alberta. That was very helpful to me, because my investigation, under section 16 of my Act, must be conducted in private, and, as I commented when I commenced my investigation, I believe that in a situation affecting as many Albertans as this one, it is preferable that the taking of evidence and the reviewing of relevant documentation be done in public. At my request, the Provincial Treasurer in turn requested Code to make all of his documentation available to me and to provide all requested assistance. Code and his staff have more than complied with that request, and the co-operation received from the Code Investigation has assisted substantially with my investigation and has greatly reduced its cost.

In addition to monitoring the Code Investigation, I have, since the commencement of my investigation on October 22, 1987, caused further investigation to be carried out as follows:

A. An in-depth review and examination of all documents obtained by the Code Investigation;

B. A further search, review, and examination of documents obtained from other involved departments of government and for the same departments canvassed by Code over differing time periods. In all, our office has reviewed in excess of 50,000 pages of relevant government documentation;

C. A review and analysis of all applicable legislation, including regulations and Orders in Council;

D. In-depth interviews, both with witnesses called to testify during the Code Investigation and others who were not called upon to testify;

E. An examination and review of selected books and records of PGL and its subsidiaries;

F. The obtaining of and analysis of detailed accounting and legal opinions regarding various aspects of the investigation;

G. A review of the relevant practices and procedures of regulation in other departments and jurisdictions, including interviews with current and past regulators and Ministers, both in Alberta and other jurisdictions;

H. An analysis of legislation, regulations, and practices regulating financial institutions in other jurisdictions, as well as analysis of current recommendations for change both in Alberta and in other jurisdictions.

I am satisfied that the information gathered by the Code Investigation and my staff is sufficiently comprehensive and complete as to allow me to be confident in the findings contained in this report.

4. TESTS APPLIED TO EVALUATE GOVERNMENT REGULATORY SUPERVISION

An understanding of the governing principles of an Ombudsman investigation is necessary to the evaluation of this report.

A. WHAT I INVESTIGATE.

Under section 11(1) of the Ombudsman Act, which reads:

> "It is the function and duty of the Ombudsman to investigate any decision or recommendation made, including any recommendation made to a Minister, or any act done or omitted, relating to a matter of administration and affecting any person or body of persons in his or its personal capacity, in or by any department or agency, or by any officer, employee or member thereof in the exercise of any power or function conferred on him by any enactment",

I am to investigate all administrative actions of government, save for a few exceptions which are outlined elsewhere in the legislation. The Chief Justice of the Supreme Court of Canada has stated that such administrative actions include "everything done by government authorities in the implementation of government policy (excluding) only the activities of the Legislature and the Courts" (Re British Columbia Development Corp. et al and Friedmann et al (1984) 14 D.L.R. (4th) 129 at 149.) As a result, in this investigation I have considered the actions of all government officials and agencies involved in the regulation of the Principal Group of Companies, including the actions of Ministers, where those actions involved administration of the legislation governing those companies. Except to the extent of considering whether existing acts or regulations are unfair or unjust, as I am required to do, I have not considered the actions of Ministers in setting legislative policy, as that is clearly excluded from my jurisdiction. A practical example is that a decision to allocate funds to support a troubled financial institution is clearly a legislative policy decision, and is excluded from my investigation; a decision to carry out or suspend enforcement of an Act or Regulation against a troubled financial institution is an administrative action within my jurisdiction to investigate, no matter whether that decision is made by an official of a department, or a Minister.

B. WHAT I AM TO LOOK FOR.

Section 20(1) and (2) of my Act set out what I am to look for when investigating. Those subsections state:

> (1) This section applies when, after making an investigation under this Act, the Ombudsman is of the opinion that the decision, recommendation, act or omission that was the subject matter of the investigation
>
> > (a) appears to have been contrary to law,
> >
> > (b) was unreasonable, unjust, oppressive or improperly discriminatory or was in accordance with a rule of law, a provision of any Act or a practice that is or may be unreasonable, unjust, oppressive or improperly discriminatory,
> >
> > (c) was based wholly or partly on a mistake of law or fact, or

(d) was wrong.

(2) This section also applies when the Ombudsman is of the opinion

(a) that in the making of the decision or recommendation, or in the doing or omission of the act, a discretionary power has been exercised

(i) for an improper purpose,
(ii) on irrelevant grounds, or
(iii) on the taking into account of irrelevant considerations, or

(b) that, in the case of a decision made in the exercise of a discretionary power, reasons should have been given for the decision.

The practice of all Ombudsman offices governed by similar legislation (and my practice) has been to interpret those statutory tests keeping in mind the basic reason for the existence of an Ombudsman, that being the appointment by the entire legislature (not the government in power) of an official in whose personal judgment that legislature has confidence, who will bring an ordinary layperson's concept of fairness to his scrutiny of all actions of government, and will use that concept of fairness in determining any shortfall in those actions, or any recommendation for rectification of a particular action or change in principle of a policy, regulation, or statute. Because my mandate is recommendatory only, and government is free to accept or reject such recommendation, I am not limited to a strictly legalistic interpretation of the section 20 tests, but am instead encouraged to consider all factors in commenting on the fairness of government action. The courts have been quick to recognize as Chief Justice Dickson stated in Friedmann

> "...the lack of any remedy at law for many administrative injustices that gave rise to the creation of the office of Ombudsman. The courts, not Ombudsmen, have responsibility for remedying violations of legal rights."

As counsel for the Ombudsman of Ontario submits,

> "the purpose of the Ombudsman Act, *inter alia*, is to create someone who can investigate actions which prejudice someone's interests even if those actions fall short of violating the strict legal rights which a court protects. To interpret (the legislation) in the manner urged by the appellants would run counter to the Legislature's clear intention to provide redress for grievances not legally cognizable" (*supra* at page 146).

As a result, while one of the criteria I must use is to determine whether a particular action is "contrary to law", the most important test which I apply in the hierarchy in values set out in section 20 is whether or not an action, in my opinion, is "wrong".

It is also clear, for that reason, that the application of these tests is somewhat subjective in nature, and is not to be taken as a form of precedent. They may well apply very differently to actions of government which might on a narrow examination of them be similar, because of differing consequences and differing classes of persons that might be affected by those actions.

C. THE LEGAL TEST

The facts that I am investigating center around the interpretation of three statutes, namely:

(1) the Investment Contracts Act ("ICA"), and its regulations,

(2) the Securities Act, and its regulations, and the published policies of the Alberta Securities Commission, and

(3) the Trust Companies Act.

In order for me to consider whether any actions by government officials being investigated are contrary to law, as set out in section 20(1)(a) of the Ombudsman Act, I must proceed from a general understanding of the legal principles to be applied in that consideration.

In that regard, I have had the benefit of reviewing the arguments presented by all counsel involved in the Code Investigation, and specifically the extensive legal reviews contained in some of those submissions. As well, I obtained a lengthy and comprehensive legal opinion from outside solicitors. The following principles, which I have used to determine, again from the layman's point of view, whether the actions of government I have examined are contrary to law, are my own conclusions from this review. Attached hereto as **Exhibit 4** is a comprehensive list of the statutes and authorities which I have considered.

It is certainly fair to say that the legal liability for regulatory actions of government is currently in a state of great change and uncertainty. In this country, however, the guiding principles have been set down by the Supreme Court of Canada in City of Kamloops v. Neilsen (1984) 5 W.W.R. 1. In that case, the building inspector for the City, through inspection, ascertained that serious deficiencies existed in the foundations of a house then being erected, subsequently purchased by the plaintiffs, and issued a stopwork order (which was ignored by the builder), and, when the building was completed, refused to issue an occupancy permit allowing it to be legally occupied. However, he did not request the City to obtain a court order to prevent the house being completed or occupied, although the legislation allowed such an application. The City was found responsible for that failure to act, to the extent of 25% of the losses of the plaintiffs.

The proposition which I take from the case, and rely upon, is that in any case involving action for government shortfall in regulation, the statute or regulations under which government is operating must be examined in detail, to determine the purpose, discretion, powers, and duties which flow from that legislation, together with facts as to the particular activity which the legislation governs, to determine:

(1) whether that legislation supports the finding of a sufficiently close relationship between the person suffering harm and the regulator that the regulator should reasonably have known that his failure would damage that person;

> (2) if so, liability should follow unless there are considerations which ought to negate or limit the scope of the duty on the regulator, the classes of persons to whom that duty is owed, or the amount of damages the injured person might ordinarily be entitled to.

While that proposition seems reasonably clear, it is difficult to apply. In the first place, a shortfall of the regulator is looked at very differently depending on whether the action or inaction of the regulator may be categorized, by reference to the legislation, as discretionary, meaning the regulator can choose to do it or not to do it in accordance with whatever policy he sets, rather than operational, meaning it is a duty required of the regulator and his decision is how to go about doing it. It may immediately be seen that hardly any action of government would fit strictly within one of these definitions or the other. For example, government inaction for reasons of no qualified personnel being in place or available, or no financial resources being available, might be policy/discretionary, or operational, or a combination of both. The importance of the distinction is that I interpret the case, and subsequent cases, to mean that if there is a discretion to carry out a duty under a statute, the decision to not carry out the duty as opposed to carry it out is not subject to legal liability unless that decision has in some way been tainted because it was made without any consideration of the relevant factors, or in consideration of factors not relevant to the purposes of the statute but for some other extraneous purpose, or was made as a result of improper or malevolent motivation. However, once the decision to act is taken, then the legal scrutiny of that action is the same as the scrutiny of a required operational action, that is not to carry out the action negligently in such a way that it would harm the class of persons that the regulator should foresee might suffer such harm from that negligence.

Therefore, in examining government action in this report, in the case of a policy or discretionary decision or portion of a decision, I will be looking to see whether it was made after appropriate consideration and for proper and appropriate purposes; in examining operational decisions or actions, I will be attempting to ascertain, in my view, whether they were carried out negligently.

It should be mentioned that there is a third category of government action which has not traditionally attracted liability, and which in my opinion still does not attract liability. That is the category of "quasi-judicial" conduct, meaning conduct where a government official or department is acting in the capacity of a court. The makers of those decisions have traditionally been free of liability to those they affect, and I do not believe that is changed by the decision in Kamloops, except that the case has clarified that if they are tainted by the same improper factors that may taint a policy or discretionary decision, they may attract liability.

Before leaving the consideration of the Legal Test, there have been a number of specific propositions supporting increased liability, and specific propositions suggesting limitation of liability, which I think must be dealt with so that it is not assumed they are part of the test that I have used to evaluate the facts being investigated, or that I have ignored them.

I have considered the following arguments that the standard of government liability should be greater than that which I have outlined above:

(1) An argument was made by counsel for Donald, John, and James Cormie that the government, because it "controlled" all actions of investment contract companies under the ICA, was the proxy (meaning a form of legal representative) of the contract holders, and was in a fiduciary position (meaning a position of utmost good faith) to those contract holders. Those propositions, if accepted, would substantially increase the liability. I do not find anything in the examination of the statute or surrounding circumstances, or any authority, that would support such a proposition and I have disregarded it in my investigation.

(2) Counsel for the investment contract holders, John G. McNiven, and other counsel, have suggested that the Superintendent of Insurance was immediately required to cancel the registrations of FIC and AIC and to refrain from renewal of any registration of those companies, by section 10 of the ICA, at any time those companies might be found not to conform to the financial tests contained in section 8 of that Act. I do not agree that it is quite so simple. It is my belief that from an examination of the entirety of the ICA, a discussion of the specifics of which appears later in this report, that there must be some discretion by both the Superintendent, and his superiors, including the Minister, in dealing with those matters. I say that because automatically to suspend a financial institution for a contravention of the section 8 tests without consideration of the circumstances might

be very harmful to everyone concerned including the contract holders to whom those officials might well owe a duty. For example, any investment contract company which had placed the majority of its investments into common stocks would undoubtedly have been required to have been suspended in October of 1987, in the wake of the infamous "Black Monday" on the stock exchanges around the world. I have therefore examined the conduct of the Superintendent in this regard in accordance with the standard tests outlined above in Kamloops.

I have considered the following arguments, suggesting limitation of liability of government to a narrower test than that I have outlined above, all made by counsel for the Government of Alberta:

(1) Counsel for the government states that the government cannot be held responsible for a failure to legislate, and cites some authority. I agree with that proposition, but would not think that it would apply to any finding as to whether at least a recommendation should be made and considered for amendment to the legislation.

(2) The suggestion is implied further in the argument by counsel for the government that the government should not be responsible at all for a decision not to act, for whatever reason, although I am assuming that would still exclude any reason of malevolence. However, in examining any discretionary decision not to act, I have had in mind the following principles;

(a) The Supreme Court of Canada stated in Roncarelli v. Duplessis (1959) 16 D.L.R. (2d) 689 "discretion necessarily implies good faith in discharging public duty; there is always a perspective within which a statute is intended to operate; and any clear departure from its lines or objects is just as objectionable as fraud or corruption." (at page 705).

(b) That passage was cited by Justice McIntyre in his dissent in Kamloops (supra), who further stated at page 20 of that case "the plaintiffs might have succeeded in this case on a showing of corruption upon the part of the City officials and council, or upon showing that the failure to prosecute resulted from considerations of extraneous or improper matters or from bad faith." Madame Justice Wilson, in writing the majority decision, quoted with approval a passage from the case Anns et al v. London Borough of Merton (1978) A.C. 728, in which Lord Wilberforce stated, "They must, therefore, make their discretionary decisions responsibly and for the reasons that accord with the statutory purpose" (Kamloops, page 24-25). She then went on in her own words to state, "In my view, inaction for no reason or inaction for an improper reason cannot be a policy decision taken in the bona fide exercise of discretion" (Kamloops, page 37).

(c) Therefore, in considering any discretionary decision to regulate or not, it is still my view that such decision could attract legal liability if it was made for considerations other than the general purposes of the statute being administered.

(3) Counsel for the government has suggested that the principle in Kamloops should be limited to cases where there has been physical harm or damage, and any recovery for economic loss only be awarded as a consequence of such damage, in accordance with legal principles that existed prior to Kamloops. I believe that the decision in Kamloops itself removes that limitation in that Madame Justice Wilson stated at page 43, "If economic loss was in the purview of the statute, then it should be recoverable for breach of the private law duty arising under the statute, whether or not it is recoverable for breach of a duty at common law." All of the statutes involved here specifically deal with regulation of financial transactions, personnel in the financial industry, or financial institutions, and it would seem strange that they would not encompass economic loss.

(4) Counsel for the government states that the principles set out in Kamloops should be substantially limited by reason of the fact that a series of subsequent cases in England, and some in other Commonwealth countries, have narrowly construed the English case relied upon by the Supreme Court of Canada, in reaching the decision in Kamloops, Anns v. Merton London Borough Council (supra). I have reviewed all of these authorities; interestingly all of the English cases having been written by one judge, Lord Keith of Kinkel. It is my opinion that those cases do not remove the principles utilized in Kamloops. They simply indicate that a very close scrutiny of the statute involved, its purposes, and the surrounding circumstances, should be made before liability is found, an approach with which I agree. There is further some suggestion that considerations of public policy should be part of the

first portion of the test as to whether a duty exists, rather than simply a limitation of the duty once it is found to exist. In my review of the facts investigated, such a change to the test would not have led me to any different conclusion.

(5) Counsel for the government states that the decision in Yuen Kun-Yeu et al v. Attorney General of Hong Kong (1987) 2 All E.R. 705, which is a decision where a claim against the commissioner of deposit-taking companies in Hong Kong for failure to exercise his authority to cancel the licence of a deposit-taking company pursuant to the ance was struck out by the court as disclosing no cause of action, may stand for the proposition that there should be no possible action under the ICA. Cases which strike out actions on the basis of the pleadings filed, without the hearing of any evidence, are always dangerous, because they may only be a result of poor or unimaginative drafting of the pleadings. A similar case, where such an action was allowed to continue, and one more germane to Canadian law, is Baird et al v. The Queen in Right of Canada (1983) 148 D.L.R. (3d) 1, a decision written by Mr. Justice Le Dain who later was elevated to the Supreme Court of Canada. That case alleged breach of statutory duty and negligence by the Minister of Finance and the Superintendent of Insurance of the Government of Canada as a result of losses from the failure of Astra Trust Company. Again, there was an attempt to strike out the claim on the pleadings. The court found that the allegations might support a cause of action, and allowed the case to continue. In assessing those cases, my solicitors prepared for me a concordance of the three acts involved, those being the Trust Companies Act of Canada,

the Deposit-Taking Companies Ordinance of Hong Kong, and the Investment Contracts Act of Alberta. The conclusion that led me to was that the statutes in each case clearly determined the decision, and it was my view that the principles set out in Kamloops would have caused the same result in each of those cases, and are still appropriate to be utilized in determining liability in this report.

(6) Finally, counsel for the government suggested that because limitation of the Anns (and therefore the Kamloops) principle was taking place in England and in other jurisdictions, Canadian courts are likely in future to limit the principle. That is not a trend that I yet see developing. On the contrary, one can draw a contrast between the most recent English case cited by counsel for the government, Hill v. Chief Constable of West Yorkshire (1988) 2 All. E.R. 238, where a claim that police had been negligent in investigating the Yorkshire Ripper murders in England and thus had negligently allowed the death of a young woman by not apprehending the killer prior to the time she was killed, was struck out as disclosing no reasonable cause of action, with the decision in Doe v. Metropolitan Toronto (Municipality) Commissioners of Police (unreported decision of Justice Henry, Ontario High Court of Justice, March 31, 1989) where a claim that the Metropolitan Toronto Police had not acted properly because they knew that a serial rapist was operating in the area in which the plaintiff lived, but failed to warn her, or apprehend the rapist prior to his assaulting her was allowed to continue. As well, I have considered the unreported decision of the British Columbia Supreme Court on October 28, 1988, of MacAlpine v. Troy Hardy et al and the Superintendent of Family and Child Service of the

Province of British Columbia, in which the Superintendent was held liable because several boys who were permanent wards of the Superintendent, and whose care had been entrusted to a "special care parent", burned down a neighbor's cottage.

While these two decisions may represent the outer limit of liability of government, and for this reason they have not affected the test that I have taken from Kamloops, they do indicate that any trend to limit Kamloops is not yet evident.

It is with the legal principles which I have outlined above in mind, that I formed my conclusions on the facts which I have investigated.

5. REGULATION OF RELEVANT PRINCIPAL COMPANIES

A. INVESTMENT CONTRACT COMPANIES

(1) Nature of Institution

The use of the terms Principal, Principal Group or Principal Group Limited (PGL) could mean different things to different people. To the public and investors, "Principal", in whatever context, was the institution to which they deposited their money. The majority of investors knew the "owner" of Principal as being Donald Cormie.

Donald Cormie in his evidence before the Code Investigation stated that reference to "Principal Group of Companies" could mean different companies at different times. The following is a short text of his evidence.

> Q. Well, I want to know which of these companies that are on this chart are in the Principal Group of Companies, as you understand that term?
>
> A. Well, it could vary according to whatever grouping you're putting together.
>
> Q. So you mean --
>
> A. Sometimes you might include affiliates, sometimes you might not.
>
> Q. Are you telling us, Mr. Cormie, then, that in your mind the Principal Group of Companies is

> sometimes one group of companies and sometimes it's another group of companies and yet on another time, a third group of companies?
>
> A. Yes, there are different companies at different times. (TR. Vol. 114, Page 21035-6)

There was such a maze of companies in the Principal Group that it would be almost impossible for the unsophisticated investor to differentiate between them.

Donald Cormie controlled another group of companies which were referred to in the Code Investigation as the upstairs companies. These were the collective group of companies; Collective Securities Inc. ("CSI") and Collective Securities Limited ("CSL"). CSI was the parent of PGL and CSL was the parent of CSI. Donald Cormie owned 100% of the shares of CSL and 80.5% of the shares of CSI. Other shareholders of CSI were: Marlin Management 10.5%, and John Cormie and James Cormie, each 4.5%.

The 1985 Annual Review which stated that in excess of $1 billion in assets were under administration, included the majority of the Principal Group of Companies.

The majority shareholder and directing mind of PGL was Donald Cormie. He exercised control over all PGL companies on a functional basis. In brief, this meant that each department, such as sales and accounting, operated under the direction of PGL (Donald Cormie).

Operating under management of PGL were a number of departments, which included:

(a) Sales
(b) Marketing
(c) Trust
(d) Finance
(e) Investments
(f) Mortgages
(g) Corporate Development

The departments reported to management committees, of which Donald Cormie was the Chairman.

Principal Group Ltd. was made up of companies involved in different financial areas. This included the investment contract companies, AIC and FIC; the Trust Company, PS&T; Mutual Fund companies, Management Companies, Mortgage securities, tax services, management services, and others. The thrust of the Principal Group of Companies was to offer one-stop financial centres, offering a range of products through the same sales force. **Exhibit 5.**

My investigation centers around the regulated companies of PGL, eg. FIC, AIC and PS&T and deals primarily with those companies outlined in **Exhibit 6.** PGL, an unregulated company, issued promissory notes to the public which are referred to later in this report.

My mandate is to investigate and report on government regulatory responsibility with respect to AIC, FIC, PS&T and PGL.

According to notices published by the Alberta Securities Commission (ASC) and the Superintendent of

Insurance for Alberta, only five companies have ever been registered under the ICA, two of those companies being AIC and FIC. By 1981 only FIC and AIC and Investors Syndicate Limited remained registered under the Act.

An investment contract is an agreement between the purchaser and the seller that, in exchange for a lump sum or series of instalment payments, the seller will pay to the purchaser, on a date set out on the contract, a fixed amount of money which may or may not include interest. Investment contracts traditionally contain provisions for a fixed amount of interest, usually at a low rate of 3% or 4%, and a provision that additional interest may be paid in the discretion of the seller by it declaring what are called "additional credits" during the life of the contract.

To meet the requirements of the investment contracts legislation, the contract must also include what is called optional settlement values, which means it must contain some provision allowing part of its value to be redeemed or converted into another form of investment, commonly an annuity, as an alternative to holding the contract until maturity or cashing it in at maturity.

The funds paid to the seller of an investment contract may be invested by it in accordance with the rules set out in the investment contracts legislation. The purchaser of an investment contract, unlike a mutual fund, does not own any portion of the investments purchased by the seller. It is a simple debt instrument; on maturity date, the seller owes the buyer a specific amount of money, no matter what success the seller has had in investing the buyer's money during the life of the contract.

There are two types of investment contracts; the instalment contract which requires the purchaser to make regular payments during its life, and the single pay contract which requires the purchaser to make a single lump sum payment at the time it is purchased. Investment contracts are traditionally marketed by an aggressive sales force, in contrast to such instruments as term deposits which are usually sought outright by the purchaser.

The single pay certificates issued by FIC and AIC were of two types:

(a) Single pay certificates with a fixed or guaranteed rate of 4% plus additional credits. This fixed rate remained static and these certificates were available for terms of 1-10 years.

(b) Single pay certificates, issued for a term of less than 1 year, with a stated rate of return.

The single pay certificates with additional credits could not be advertised whereas those with the stated or fixed rate of return could be.

The additional credit was not a certainty, therefore the regulators would not allow those certificates to be advertised. The short term certificates had a stated rate of return and therefore advertising was allowed.

A joint Provincial and Federal Study of the Investment Contracts Industry was carried out by a Committee established by the Federal Government and all Provincial Governments, which deliberated from 1966 to 1969. A report was published by the Committee in 1969 entitled, "Report of the Canadian Committee on Mutual Funds and Investment Contracts". That report gave an effective description of the investment contract industry and a comparison of it to other financial entities. It pointed out that the investment contract industry grew by selling itself as providing a method of forced saving. However, it commented that given the fact that "additional credits" are discretionary and need not legally be paid, investment contracts are not competitive with other types of debt instruments such as term deposits. As well, investment contracts are usually not comparable in yield to term deposits, because additional credits are traditionally declared as a percentage of the principal value of the contract at that time, and not the accumulation of principal and interest or previous additional credits, so that the contract holder does not get the benefit of interest on interest available to purchasers of a term deposit.

The report further stated that its study showed that the majority of investment contracts sold in the 1966-1969 period were sold to low income purchasers, and were represented by salespersons to those purchasers to be a good method of forced saving for persons with small amounts to invest. It was concluded by the study that because investment contracts are designed to provide maximum compensation to the salesperson at the time they are purchased, and because more than half of the instalment investment contracts went into default because regular payments were not made, a large portion and sometimes all of the instalments paid were forfeited and went to pay the sales and general expenses of the seller. Similar losses were shown if a purchaser of a single pay contract attempted to use the methods of optional settlement early in the term of the contract, because the value of such settlement took into account the large sums paid at the outset for the sales expenses and commissions. The Committee considered investment contracts to be a rather poor investment. The study also commented upon the increasing volume of single pay contracts and pointed out it was difficult to distinguish single pay contracts from competing financial investments such as term deposits. The study concluded, unequivocally, that:-

> "A company which issues single payment contracts exclusively ought not to be treated as an investment contract company. It should instead be regulated as a trust company or some other type of financial institution."

In dealing specifically with FIC and AIC, it must be noted that by the 1980's, the majority of those companies' business was in single pay contracts, and at the time that the companies ceased to operate in 1987 about 95% of the outstanding contracts were single pay. As the study concluded, single pay contracts were not the type of financial instrument that investment contract legislation and regulation was designed to control.

At the Code Investigation, Gordon Barefoot gave expert evidence with respect to the change from accumulation plans to single pay contracts by FIC and AIC.

A schedule for FIC was prepared by Barefoot and tendered at the Code Investigation as an exhibit. The following is the detail of those schedules for the 10 year period 1976-1986.

Year	(1) Instalment Certificate	Single Payment Certificate	Total	Total Certif. Liabilities % Inc/(Dec) From Prior Year
1986	$17,257	$297,924	$315,181	0.94%
	5.5%	94.5%	100.0%	
1985	$18,785	$293,456	$312,241	2.0%
	6.0%	94.0%	100.0%	
1984	$20,188	$286,063	$306,251	24.6%
	6.6%	93.4%	100.0%	
1983	$20,506	$225,234	$245,740	8.1%
	8.3%	91.7%	100.0%	
1982	$20,486	$206,738	$227,224	39.6%
	9.0%	91.0%	100.0%	
1981	$23,304	$139,456	$162,760	31.9%
	14.3%	85.7%	100.0%	
1980	$25,490	$ 97,945	$123,435	37.6%
	20.7%	79.3%	100.0%	
1979	$26,047	$ 63,630	$ 89,677	35.2%
	29.0%	71.0%	100.0%	
1978	$25,964	$ 40,369	$ 66,333	33.3%
	39.1%	60.9%	100.0%	
1977	$25,588	$ 24,191	$ 49,779	3.7%
	51.4%	48.6%	100.0%	
1976	$25,741	$ 22,253	$ 47,994	6.5%
	53.6%	46.4%	100.0%	

(2) Relevant Legislation and Regulations

Legislation:

The relevant legislation to my consideration of the actions of the Alberta regulators in regulating the sale of investment contracts is the ICA. That Act first came into force in Alberta on April 11, 1957. Prior to that date investment contract companies were regulated by the Board of Public Utility Commissioners under the Alberta Securities Commission ("ASC"). The ICA has not changed in any significant way since it was enacted in 1957.

The major provisions regulating issuers under the ICA can be summarized as follows:

(a) Registration - no issuer or salesman can issue or sell investment contracts unless registered under the Act; (s.3)

(b) Paid-in capital - the issuer must have a minimum of unimpaired paid-in capital of $500,000, unless, by prior approval, that amount has been reduced to $250,000; (s.8(b)) The Alberta regulators considered the section 8(b) test to be the most important and evidence to that effect was presented at the Code Investigation.

(c) Depository - the issuer must have on deposit with a chartered bank or trust company in Canada, qualified assets aggregating in an amount not less than the amount for which the company is liable at the time of calculation to pay in cash to the holders of its investment contracts (the formula for valuation is also contained in the Act); (s.8(c))

(d) Reserves - the issuer must maintain reserves, which, given certain assumptions, will yield an amount at least equal to the face or maturity value of the investment contracts when due; (s.8(d))

This simply means that an issuer must maintain qualified assets equal to the reserves for outstanding contracts.

Evidence at the Code Investigation showed that for investment contracts entered into on or after November 1, 1980, the Superintendent approved maximum assumed reserve rates as follows:

Single pay contracts up to 5 years	7%
Single pay contracts 6 to 10 years	6%
Instalment contracts up to 5 years	5.5%
Instalment contracts 6 to 10 years	5%
Instalment contracts 11 to 15 years	4.75%
Instalment contracts over 15 years	4.75%
Extended benefits after maturity	3.5%

(Exhibit 552 at 612)

With respect to additional credits, they were recorded as liabilities once they were declared. The financial statements of FIC and AIC showed the additional credits and reserves under the heading "certificate liabilities and reserves".

(e) Investments - the issuer may only invest its funds in investments that a company registered under the Canadian and British Insurance Companies Act may invest its funds. (s.34)

(f) Forms - all forms and brochures used in the sale of investment contracts must be approved by the Superintendent of Insurance; (s.24 & 25)

(g) Financial Information - an issuer must file prescribed financial statements at least once per quarter, disclosing its reserves and qualified assets, on deposit with the Superintendent of Insurance. On a yearly basis, it must provide an audited financial statement within 90 days of its year end, together with a balance sheet which must conform to specific requirements in the legislation. (s.26)

The above features of the ICA are markedly different than the requirements under the Securities Act, which governs the majority of investments made in Alberta. The philosophy under the Securities Act is to ensure disclosure of material information to the public, while under the ICA, material information is disclosed to the Superintendent of Insurance and there is no requirement that material information be disclosed to the investors. Under the Securities Act, there are no minimum financial requirements for an issuer, while there are strict financial requirements under the ICA. The financial requirements are that an issuer under the ICA must have a minimum paid-in capital, must maintain enough qualified assets at a chartered bank or trust company to meet the cash value of its liabilities pursuant to its outstanding investment contracts, and must maintain reserves to meet the face value of the investment contracts at maturity.

Under the Securities Act, there are no restrictions as to how an issuer may invest the funds it receives from investors (although the Securities Commission does have the discretion to not issue a receipt for a prospectus where the business purpose appears to be dubious), while an issuer under the ICA is restricted to what one generally considered to be "safe" investments. In fact, the ICA has several similarities to bank or trust company legislation, which legislation is designed to govern deposits rather than investments carrying risk.

It is clear that the ICA attempts to provide some protection because it views the investment contract as at least a hybrid between an investment and a deposit, requiring some feature of safety similar to certificates of deposit of banks or trust companies. However, the Act does not provide nearly the protection of legislation governing major financial institutions. In particular, the requirement of $500,000 in unimpaired capital provides little protection. Bank and trust company legislation traditionally requires a borrowing to capital ratio of, as an example, 15:1. That means for every $15,000 on deposit, the institution has to hold unimpaired capital of $1,000. It may be seen that capitalization of $500,000, using such a ratio, would only safely support deposits of $7.5 million dollars. Therefore, the larger the deposit base, the more inadequate the capital base of an investment contract company. At the time they ceased operation, FIC had outstanding investment contracts in the amount of $363,995,942.20, and AIC had outstanding investment contracts in the amount of $127,911,033.32. They were obviously seriously under-capitalized if a capital ratio was considered necessary for safety. This is the major reason that the 1969 study concluded that the investment contracts legislation and regulatory scheme was unsuitable for a company selling single pay contracts.

(3) Description of Regulatory Methods:

The regulation of investment contract companies in Alberta, firstly by the ASC and latterly by the Superintendent of Insurance, was carried out in the same way. In general terms, auditors who reported to the Superintendent of Insurance and who were familiar with financial institutions would conduct a number of regular examinations of investment contract companies. They would conduct an informal or desk examination of the quarterly or monthly financial statements, and once a year a detailed examination would take place based on the audited financial statements and the Statement of Assets required to be filed on a yearly basis. This detailed examination would often include attendance at the premises of the investment contract company to verify information.

My investigation has disclosed there was no serious difficulty with the auditors obtaining information or being free to report on it throughout the entire time that FIC and AIC were subject to regulation. This information was derived by the auditors in accordance with audit programs designed to deal with investment contract companies, which were amended from time to time and were in turn developed from a review of the provisions of the

ICA. The focus of the audit examinations was always on whether or not the company met the requirements of the minimum capital, depository of qualified assets, and reserve tests specified in the Act. These tests will be referred to throughout the remainder of this report generally as the "section 8 tests", as they arise out of section 8 of the ICA. The auditors would submit reports of their findings to the Chief Auditor or Director of Audits, who would in turn report to the regulator, in early years, the Securities Commission, and latterly, to the Superintendent of Insurance.

The Superintendent of Insurance has a number of powers to enforce regulatory requirements of the ICA. For example, he has the right to withdraw registration of an issuer on any ground that would justify refusal to grant a new registration or a renewal of registration. He may further withdraw registration if it appears to him from the statements filed or investigation of those statements that the issuer would be unable to provide for the repayment of its investment contracts at maturity. If the Superintendent believes that the amount of a mortgage held as an investment by an investment contract company is more than the value of the property, or the property value will not repay the loan and interest, he may obtain an appraisal and cause the value of the asset to be reduced to that appraised value. Those amended values are important in meeting the valuation tests for the deposit and reserve requirements under the Act. Such decisions of the Superintendent are subject to appeal to the ASC and then to the Court of Appeal.

The Superintendent also has the right to make a Special Report to the Minister of the Department to which he reports if he is satisfied, for example, that the issuer has defaulted on its liabilities, contravened the Act, or allowed a situation to exist, the effect of which is prejudicial to the contract holders. He may further make such report if the issuer fails to meet the capital, depository, or reserve tests in the Act. Such a report allows the Minister to recommend to the Lieutenant Governor in Council (the Cabinet) that a Receiver and Manager be appointed to take over the affairs of the investment contract company, or to recommend the company be wound up. The Lieutenant Governor in Council, after such recommendation, has the power to carry out those recommendations.

During most of the time relevant to my report, James Darwish, Ronald Kaiser and Tewfik Saleh served in succession as Superintendent of Insurance. Both Darwish and Saleh testified and stated to me in interviews that while the Superintendent possessed these powers in theory under the Act, in practice they would not exercise them without the approval of the Deputy Minister and the Minister. They differed, however, in that Darwish indicated that in an extreme case a Superintendent, having the statutory responsibility, might be required to act without obtaining such approval; Saleh did not agree. Aside from the audit programs, no policy or procedures were developed by the office of the Superintendent of Insurance or by any of the ministries that governed the Superintendent of Insurance regarding the method of carrying out regulatory duties under the ICA.

B. COMMENTARY AND ANALYSIS OF REGULATORY HISTORY

In my examination of the investment contract companies, I have broken my review into specific periods of time, as follows:

(1) August 31, 1954 to December 31, 1972
(2) January 1, 1973 to December 31, 1983
(3) January 1, 1984 to December 31, 1984
(4) January 1, 1985 to June 30, 1986
(5) July 1, 1986 to June 30, 1987

These periods have been chosen as they represent what I believe to be a special grouping of events of regulation.

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(1) Regulatory Events for Time Period Aug. 31/54 to Dec. 31/72

During this period, I will briefly review the actions of FIC and AIC with the Alberta regulators. For AIC, I will confine my review to the period commencing in December of 1962, when that company was acquired by what has become known as the Principal Group from Equitable Investment Corporation of Ohio. AIC was always based in Edmonton and had been founded in 1948 by H. Curlett of that city. FIC had been founded in 1954 by Donald Cormie along with some associates. As the years passed, the Cormie family obtained and consolidated control of both companies through what generally came to be known as the Principal Group. It is interesting to note that part of the capital used to retire the debt incurred to acquire AIC was provided to the Principal Group through an investment trust known as the Hutterian Brethren Trust, which will be described more particularly later in this report.

It is clear from a review of the documentation of ASC, the regulatory authority over investment contract companies including FIC and AIC during this period, that the companies early on developed and followed a pattern of operating to the very outside limits of the legislation and of challenging the regulators on every matter raised. It will be seen in later segments of this chronologic review that this conduct on the part of FIC and AIC persisted until the company ceased business in 1987. In that regard, the companies took full advantage of the deficiencies in the ICA financial requirements and the ambiguous drafting of the specific terms of the statute in order to take the opportunity to argue with the methods of calculation used by the regulators to monitor the capital, qualified assets depository, and reserve requirements.

The following is a summary of some of the more important events during this regulation period.

In 1958, it was pointed out that increased capital was necessary to enable FIC to meet the financial requirements of the ICA. The question of capitalization and meeting of these minimal requirements continued to be a problem throughout the life of the company.

In 1959, company officials withdrew large amounts of money to pay off personal loans, which resulted in criticism and threats of enforcement action by the regulators.

In 1960, the problem first arose with FIC that it had acquired real estate, in part for its own use, which the regulators did not believe could be accepted as a qualified asset to meet the financial tests of the ICA. This disagreement over interpretation continued up to the time the company ceased business.

The evaluation of Athabasca Holdings Ltd. ("AHL") shares, which formed part of the asset base of FIC, became an issue. This company was a subsidiary of Collective Securities Ltd. ("CSL"), the parent of the Principal Group at that time, and in turn owned a number of other Principal subsidiaries. There was no real market for those shares. FIC evaluated the share position at $295,000; the regulators attributed a value of $60,000 to $75,000. Even at those figures, the regulators objected to FIC purchasing shares in a non-arm's length company.

In 1961, the regulators expressed concern about management fees being paid to Estate Loan and Finance ("EL&F") and Collective Securities Ltd. ("CSL") by FIC. CSL and EL&F were owned or controlled by Donald Cormie and were within the Principal Group.

In 1961, FIC began a practice of manipulating the value of properties through agreements for sale to convert non-allowable assets into qualified assets. The regulators suggested an amendment to the ICA to provide a clear and proper definition of a qualified asset. No such amendment was enacted.

In 1963, the regulators became concerned that a strong part of the "sales pitch" by the sales people selling FIC and AIC products was that the companies were supervised and controlled by the government. No real progress was ever reached on this issue.

In 1964, Donald Cormie launched a verbal assault against the regulators at a Cabinet Committee meeting of government, as a result of criticism of the sales practices of FIC and AIC. Although this method of attempted intimidation did not appear to be very successful, the approach continued to surface again and again in the following years.

In 1965, the ASC pointed out to the companies that the Canadian and British Insurance Companies Act ("CBIC Act"), which governed investment by investment contract companies, did not allow shares of related companies, including companies where there was a commonality of the Board of Directors, to be considered as a qualified asset. FIC and AIC proposed the idea that if Donald Cormie did not appear as a director of the investment contract company or the company invested in, the legislation could be complied with. This was accepted by the regulators, however, it was clear that as principal shareholder he could and did still elect his own Board of Directors and dictate policy.

In 1966, the Superintendent of Insurance of Saskatchewan caused a Special Report on AIC to be prepared by Peat Marwick Mitchell and Co., as a result of concerns about its condition and compliance with the Saskatchewan legislation. Examples of the problems discovered were that values of mortgages were overstated, appraisals supporting those values were not independent, and numerous intercompany transactions were taking place. Also, large dividends and high management fees were being paid to companies not related to the business of AIC, such as Cormie Ranches Ltd. As a result of this Special Report, the registration of AIC in the Province of Saskatchewan was not renewed. All of these concerns were freely shared by the Saskatchewan Superintendent with the ASC.

In 1967, the Chairman of the ASC refused to accept certain investments of AIC as qualified assets to meet the financial requirements of the ICA. He wrote the company to that effect and advised them that such written notice constituted a formal ruling under the ICA. This procedure was effective, as although the company had the right to appeal the ruling to the full Commission and to the Court of Appeal, they did not do so. It is unfortunate this procedure was never used again by Alberta regulators prior to FIC and AIC ceasing business.

In 1968, the regulators complained that AIC had to borrow money to meet maturing contracts at the same time that significant dividends and management fees to related companies were being paid.

In 1969, the auditors at the ASC complained that the financial statements of PGL showed funds borrowed from FIC were used to reduce an account payable to CSL.

In 1970, ASC auditors were concerned that FIC borrowed one million dollars to meet certificate redemptions but at the same time loaned an almost identical amount to its parent company.

In mid 1970, a report by ASC auditors stated that both companies should ultimately be solvent, however, on an immediate breakup basis both were bankrupt and certificate holders would suffer a loss.

In 1971, AIC was deleted as an approved corporation under the Trustee Act of Alberta because of its serious financial situation. Under that Act, compliance with which was the responsibility of the ASC, the Lieutenant Governor in Council could approve corporations as being appropriate recipients of funds to be invested by persons controlling trust funds. One of the requirements under the Act was that such a company must demonstrate one million dollars in unimpaired capital. Clearly, AIC could not meet that test.

Further in 1971, the regulators began a lengthy disagreement with the term "guaranteed" being used in the brochures and advertisements used to promote investment contracts sold by FIC and AIC. The companies were continually successful in combating this concern by arguing that their competitor, Investors Syndicate Ltd., had historically been allowed to use this terminology. Investors Syndicate Ltd. was a much more solid company, and was receptive and cooperative to regulation.

In mid-1971, the members of the Securities Commission became quite alarmed at the deteriorating condition of FIC and AIC and, at the same time, wanted to meet and refute the continual criticism, directed to the political level, of the work of their staff by Donald Cormie and his associates. They therefore sought the permission of the Attorney General, Edgar Gerhart, to obtain an independent report on the companies and the ASC's methods of regulation. That report was prepared on June 11, 1971, by A. G. Burton, F.C.A., of Peat Marwick Mitchell and Co. That report supported the conclusion of ASC personnel about the affairs of FIC and AIC, but pointed out that amendments to the ICA were necessary in order to allow regulators to be effective in causing change to the company's operations. The report stated clearly that the only effective remedy available to the regulators was to suspend registration of the companies, and that was far too drastic. Unfortunately, the suggested changes to the ICA were never implemented.

In 1972, the B.C. Securities Commission held a hearing into the affairs of FIC and AIC out of concern that their financial condition did not meet the financial requirement of the B.C. investment contracts legislation.

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(2) Regulatory Events for Time Period Jan. 1/73 to Dec. 31/83

The following is a brief chronology of the events during this period of regulation. It is clear that the companies' policy of constant challenge to attempts at regulation continued.

On March 21, 1973 the ASC wrote to Donald Cormie stating that the serious deficiencies of qualified assets in the two contract companies could result in non-renewal of registration in British Columbia. If this occurred it could precipitate a crisis in Alberta. Donald Cormie replied to this letter and said he personally avoided exercising control over the contract companies and could do nothing but follow the recommendations of the management and the Directors who in effect were "trustees" for the certificate holders and himself as a stockholder.

As a result of the B.C. Commission hearings in 1972, in March of 1973 the B.C. regulators accepted the President of AIC's notice that registration would not be sought for 1973/74 for that company.

A meeting was held on March 30, 1973 between the ASC and the President and Directors of AIC, concerning the affairs of AIC. The Chairman of ASC advised the President of AIC that the Commission was not impressed with the manner in which AIC was being operated. Although instructions were issued by the Chairman to register the company, the Commission at the same time forwarded a Special Report under the ICA to the Minister on the deficiencies of the company with the recommendation that a receiver/manager be appointed. As a result of the letter sent to the President of AIC by the Chairman, the Directors of the company assured the ASC that they were proceeding with despatch to cure the outstanding deficiencies of the company. In view of this, the Commission felt compelled to allow them the opportunity to "put their house in order". The recommendation for appointment of a receiver/manager was withdrawn.

At this time the administration of the ICA was being transferred from the ASC to the then Department of Consumer Affairs and it was recommended the new proposed Uniform Investment Contracts Act, which arose out of the 1969 study and report, be legislated into effect providing stronger and clearer legislation for the companies and regulators. Similar recommendations were made repeatedly throughout the life of FIC and AIC. It was also suggested at this time that consideration be given to negotiating an agreement with the CDIC for insurance coverage for investment contract companies. Neither happened.

In July of 1973, James Darwish, recently appointed Superintendent of Insurance in the Department of Consumer and Corporate Affairs (CCA) and responsible for administering the ICA, wrote to his previous superior, the Chairman of the ASC, suggesting a review of the Principal Group of Companies, including both regulated and non-regulated companies, by an outside independent firm of chartered accountants. Darwish felt this was the only procedure available to establish a proper connection between CSL, PGL, PS&T, FIC, and AIC. The Chairman of the ASC agreed to an examination of the regulated companies only, with the others to be considered depending on what arose from those examinations. An outside examination of FIC and AIC was conducted by the firm of Ernst & Ernst, Chartered Accountants. A report on AIC was submitted in February, 1974 and on FIC in May, 1974. Donald Cormie complained about this examination, inferring "leaks" of information concerning his companies, questioning Ernst & Ernst's attitude, and stating that there might be false and misleading information contained in the report due to the regulators' influence on Ernst & Ernst.

On completion of their examination, Ernst & Ernst recommended the following amendments to the ICA:

(a) A change be made in method of filing the annual financial statements.

(b) A borrowing to capital ratio be introduced.

(c) The size of individual investments be limited to a percentage of the total unimpaired capital of the company.

(d) Introduction of minimum liquidity requirements and general asset ratio guidelines.

(e) More precise definition of the types of securities in which a company could invest.

(f) Prohibition for not only directors, officers and employees from dealings with the company, but also shareholders and affiliated companies.

The Ernst & Ernst Report on both AIC and FIC provided a very lengthy and detailed examination of the affairs of the companies. The report commented that it was evident the investment contract companies were not being operated in a prudent manner, and the shareholders of the company were using every tactic possible to circumvent the provisions of the ICA. Ernst & Ernst clearly defined the areas in which the companies were outside the provisions of the Act, including:

(a) Deficiency in qualified assets.
(b) Inter-company transactions.
(c) Unduly large holdings of real estate obtained in satisfaction of debts.
(d) Certificate settlement and loans exceeded new certificate deposits.
(e) Transactions with shareholders and affiliates.
(f) Inadequate control over assets on deposit.
(g) Administration charges by the parent.
(h) Deficiency in unimpaired capital and reserves.
(i) Over-valuation of real estate.
(j) Lack of continuity of management.
(k) Matching of assets with liabilities as they become current.

Subsequent to the examination by Ernst & Ernst, the regulators caused the reports to be examined by Shortreed Shoctor, a law firm in Edmonton, and Don Gardner of Clarkson Gordon and Company, auditors. The resulting joint report was very detailed and again clearly pointed out flagrant violations by the investment contract companies of the ICA. Shortreed and Gardner outlined the following deficiencies:

a) The companies were deficient in qualified assets, unimpaired capital, and reserves.

b) Mortgages had been taken in excess of 75% of appraised value, contrary to the legislation.

c) Prejudicial non-arm's length real estate transactions.

d) Agreements for sale had been accepted as qualified assets that did not meet the legislated requirements.

e) A state of affairs existed which could be prejudicial to the contract holders.

f) The depository (a chartered bank required to hold assets under the ICA) had no real control whatsoever as to what assets went in and what went out.

g) The ICA provided limited powers to the Superintendent of Insurance to rectify these deficiencies.

Many of these same problems still existed within the companies when registration was cancelled in 1987.

The recommendations by Shortreed and Gardner were as follows:

(a) That all matters identified as being prejudicial to the contract holders be rectified.

(b) That there be far-reaching amendments to the ICA for the protection of the investment contract holders. Adoption of the proposed new Uniform Investment Contracts Act would provide the regulators the necessary remedies to provide protection.

It must be pointed out at this stage that while Shortreed and Gardner stated that the departures from the Act were serious, based upon the Ernst & Ernst Report, the investment contract holders were not in immediate jeopardy and the prejudice that existed could be removed if conditions were laid down requiring the companies to conform with the Act on a strict timetable.

In March of 1975, Darwish wrote to Robert Dowling, Minister, with respect to the Special Report on the contract companies. He noted there had been a comment that while it may be the investment contract holders were not "in immediate jeopardy", this was partially due to the fact there was a cash flow resulting from continuous payments received from instalment contracts and sale of new contracts. Darwish stated:

> "A company such as this could conceivably limp along for many years using this cash flow. I am concerned however that all deficiencies be rectified as soon as possible so that new funds received from the public will be going into the company, that is in compliance with the Act. Consideration should be given to submitting the E & E Report and the S & G Report to the Attorney General's Department with a view to ascertaining if there has been a breach of trust or other Criminal Code violations."

Again no action was taken on amending the ICA and it does not appear the reports were sent to the Department of the Attorney General.

In July of 1975, the regulators noted the continued movement away from accumulation plans to single pay contracts. Single pay contracts were similar to term deposits or guaranteed investment certificates sold by banks and trust companies.

In the latter part of 1975, the proposed Uniform Investment Contracts Act was sent to interested parties and companies to seek their response. Donald Cormie responded saying he was "stunned" and "dismayed" with the "radical" provisions of the proposal. Further, he feared new proposed legislation would make it impossible for his companies to operate.

The new Act was never tabled before the Legislature requiring the regulators to continue to attempt to regulate the contract companies with an Act that had ambiguous terms and limited authority. Darwish, in his testimony before the Code Investigation, when asked about the proposed Act, stated: (Page 25593, Volume 138)

> Q. Were you ever told by anyone as to why it was not proceeded with at this time?
>
> A. I don't recall being told.
>
> And continued on to say:
>
> Q. Why was it not pursued or apparently not pursued with some vigour at the next session in, say 1976 or '77?
>
> A. Well, I didn't -- I don't know. I guess I -- from my own personal point of view, I guess I felt that maybe it wouldn't seem timely to do that. And unfortunately, maybe at the same time the companies, as you recall, were --
>
> Q. Things got better?
>
> A. Things got better. So I didn't think I should pursue it.

Graham Harle, the Minister of CCA from 1975 to 1979, when interviewed stated when he took over the Department from the previous Minister, Dowling, the Department was in a state of evolution.

The regulators, at that time, were Jack Lyndon, Deputy Minister, and the Superintendent of Insurance, Darwish. Harle recognized Darwish as being a very competent regulator and had a great deal of respect for him as he performed his work in a very thorough and careful manner. Harle felt the ICA was being properly enforced. Because of a period of rapid inflation in the economy in Alberta at that time, he was busy with consumer protection legislation and he did not recall matters with respect to the ICA being raised in the Legislature during his term as Minister. He spent a lot of his time dealing with a new Trust Companies Act that was being formulated.

Harle recalled a proposal to introduce a new ICA as there had been concerns expressed by the regulators of AIC and FIC, that the existing legislation was inadequate. Recommendations in the Shortreed Report and the Ernst & Ernst Report expressed the need for new legislation. He felt new legislation would better protect the public, but regulators had advised him they were to the point where they might recommend removal of the licences of FIC and AIC. He also had before him the proposed new ICA. He was concerned the removal of the licences would come under the old ICA when at the same time there was a proposal to put forward a new ICA, and he did not want to proceed with the new legislation until the current matters under the Act were settled. Harle discussed with the regulators the potential of having to remove the AIC and FIC licences. He states he advised the regulators that if they were sure of their grounds he would support them.

Harle inquired of Lyndon at a later date if there were any further problems. It appeared to him that the problems had been resolved and a request to him to introduce the new Act did not surface again. He felt the economy was into a period of inflation at this time and with the assets of the company increasing in value at an inflationary rate, this dealt with any deficit within the companies.

In early 1976 a review conducted by the auditors did show that AIC and FIC's financial condition had improved and deficiencies in assets held against reserves had been eliminated.

In June of 1976 the auditors noted improvements in the financial condition of AIC as at December 31, 1975, however, there continued to be concern with the accounting practises of the company.

During 1977, the chartered accounting firm of Clarkson Gordon were asked by the auditors to provide an opinion on the amount of administration and service fees charged by PGL to affiliated companies. Although the firm was unable to obtain access to all of the PGL records, they were able to advise in December of that year that based on the data they were able to get, their opinion was that fees charged by PGL were excessive. The question had arisen when the Superintendent of Insurance indicated concern that payments made by FIC and AIC for these services were a drain on their capital.

On May 18, 1978 there was a complaint by an investor to CCA to the effect her investment in PS&T had been transferred to AIC without her knowledge. Eventually the complainant was satisfied by having it placed where originally intended but the regulators were concerned that problems could arise when three or four companies were operating from one office. There was also concern that the investor had been told that investment contracts were given the same protection as a GIC was given by CDIC. As a result of this, a meeting between the Superintendent of Insurance and the President of AIC, Marlin, resulted in the President being advised to make it clear to all his salesmen and managers involved in marketing the products of the trust company or investment contract companies of the differences in these contracts and the security behind them. Marlin agreed.

On October 10, 1978, Darwish wrote to Marlin and confirmed his understanding, as a result of meetings held, of steps that had been agreed upon to ensure the companies continued to be financially sound and viable. Because of the lack of legislation and regulation, Darwish attempted to set out policy and guidelines that were to be followed by the contract companies. In correspondence to Marlin on October 10, 1978, regarding FIC, Darwish, after stating, "...as suggested by you and modified by some small degree at our meetings on July 21st and September 8th, 1978," outlined what he felt to be the agreed upon guidelines, as follows:

> "(1) Monthly financial statements will be submitted to this office in lieu of quarterly audited financial statements.
>
> (2) FIC will increase and maintain its 'excess of qualified assets' over 'certificate and other liabilities' so that the 'certificate and other liabilities' will not be more than 25 times the 'excess of qualified assets'.
>
> The ratio of 25:1 is, of course, more liberal than the 20:1 ratios used in Ontario, Quebec, Saskatchewan and perhaps other Provinces.
>
> (3) The subordinated debentures receivable from Principal Group Ltd. and the security to the debentures will not be altered in any manner whatsoever, until the above ratio of 25:1 is attained. When the ratio has been achieved and if the security to the debentures is to be reduced or varied, your company will give prior notification to the Superintendent of Insurance.
>
> (4) FIC will continue to reduce the amount of bonds purchased on margin, which at July 31, 1978 totalled $4,570,785, in order

> to eliminate the margin account entirely by December 31, 1978. No further investments on margin are to be made by FIC.
>
> (5) It is your desire to continue with the same management agreement presently in effect as you consider the fees to be fair and correct due to FIC's greater involvement in monthly pay contracts. You have agreed, however, to review it to see if it can be changed so as to lower the cost to FIC."

Darwish asked to be advised if his interpretation was incorrect on any item. No corrections were requested, however FIC, subsequent to this date, never did follow the policy that had been agreed upon.

Darwish stated that he further believed there was an agreement with the companies and that the companies would comply with the Federal Department of Insurance mortgage guidelines. On November 3, 1978, he wrote to Marlin to confirm that he was prepared to allow the same limits on the size of individual mortgages taken by FIC and AIC as was allowed by the Federal Department of Insurance, and enclosed a copy of those guidelines. Those guidelines, in brief, limited the maximum size of single loans to 15% of the borrowing base of the lender for uninsured mortgages, 25% for privately insured mortgages, and 35% for government insured mortgages, which limits could be increased if the loan was made to a contractor or a developer building a project. There were also limits on the percentage of loan portfolio related to particular types of property, and other limits. Darwish said to me in interviews, and testified, that he thought he had achieved a "gentleman's agreement" with Marlin on both the liability to capital ratio and mortgage guideline issues.

During the Code Investigation the matter of these agreements was raised. Marlin stated that he received the letter of October 10, 1978, but did not agree with the 25:1 ratio. He stated that at no time did he correspond with the Superintendent voicing his disagreement.

Darwish was examined by Neil Wittmann at the Code Investigation on these issues. (TR. Vol. 137, Page 25400-01)

Q. All right. Is it your recollection that Mr. Marlin agreed on behalf of FIC and AIC to maintain this 25-to-1 ratio?

A. Yes, it is.

Q. You say at the bottom of page 523, second-last paragraph, "The foregoing is my understanding of our discussions. If I am incorrect in any item, please advise."

Then there, annexed in this exhibit at page 524, there is a letter that we've seen in evidence before relating to mortgage guidelines. That letter is dated November 3rd, 1978.

A. Yes.

Q. Mr. Marlin is being written to by you, and you say, "This will acknowledge your letter of October 31, 1978 concerning the above. What I said during our meeting was that I was prepared to allow the limit on the size of individual mortgages that FIC and AIC would make to the same limits that the Federal Department of Insurance uses. In this regard I'm attaching a photocopy of the mortgage guidelines used", and so on, and then those guidelines are attached.

Continuing: (TR. Vol. 137, Page 25402)

Q. In this letter in the second-last paragraph, he says, "This will confirm that the companies will in future comply with the mortgage investment restrictions set out in the Canadian and British Insurance Companies Act." And the third-last paragraph says, "You stated that the requirements as set out in the Federal Act would be acceptable from your point of view."

Those are the mortgage guidelines you're referring to in your reply; is that true?

A. That's true.

This may be contrasted with what Marlin had to say on being examined by Wittmann:

Q. It references in the first paragraph, and the subject matter is AIC and FIC, that neither company meets the 25 to 1 ratio that was arrived at by agreement with the branch and the president of the companies. The president of the companies being yourself, correct?

A. That is correct, yes.

Q. Did you, Mr. Marlin, agree to the 25 to 1 ratio of capital to liabilities that is indicated in this government memo?

A. No, I did not agree. The Act didn't call for it. I remember the discussions at that time and agreeing that it would be desirable, but at the same time, saying that we should change the reserve -- the assumed rate, if we are going to maintain a capital ratio.
(TR. Vol. 65, Page 11815)

The matter of the mortgage guidelines was raised by Mr. Code, the Inspector, during cross-examination of Marlin by Ken Chapman.

INSPECTOR: Just to go through with that, though, they sent you a set of guidelines which you completely ignored and didn't send back a set of guidelines of which you were going to follow?

A. No, apparently we didn't get -- we didn't follow through with the recommended guidelines to suit the investment contract companies.

INSPECTOR: Nor could we find anywhere in writing that you were not going to follow what their guidelines were. You were going to continue to do just exactly as you wished despite what they wanted as a guideline?

A. I don't think that's quite fair. That's certainly not the impression I had of what we were going to do.
(TR. Vol. 70, Page 12516)

The October 10th letter was referred to again by Gary Greenan in cross-examination of Marlin. He confirmed the regulators, on a recurring basis, would write the company and tell them they were not maintaining the 25:1 ratio. He agreed they could not meet a similar ratio set down by the Saskatchewan legislation and were deregistered there for a period of time. Marlin was questioned as to whether he expected the ratio of 25:1 to be imposed as part of the proposed ICA legislation and he confirmed that they were expecting an amendment to this effect. He confirmed that one of the reasons the ratio was likely to be imposed was that the investment contract companies were becoming more like trust companies in that they were selling single pay certificates. When questioned on this, Marlin's answer was, "Yes, the volume of single pays were increasing. As interest rates increased, terms got shorter. So where initially even the single pays were long term, the single pays became short term as well." (TR. Vol. 74, Page 13291)

On March 14, 1979 the regulators corresponded with FIC and pointed out that complaints and inquiries from the public showed there was confusion as to the security and protection features of investment contracts as compared to Guaranteed Investment Certificates. Concerns were raised that the letterhead of PS&T (stating it was a member of CDIC) was being used in correspondence relating to AIC contracts. There was also concern that a consumer might understand from a salesman that compliance with CBIC Act investment guidelines was better than CDIC coverage. Contact with CDIC by the Director of Trust Companies indicated there were numerous problems across Canada involving the Principal Group and investments insured by CDIC.

In June of 1979 the regulators rejected proposed advertising incorporating FIC and AIC with an ad that mentioned "a member of CDIC". It was felt this type of advertisement could easily be misread and was confusing to the public.

However, it must be noted that in June of 1979 the auditors' annual examination of AIC and FIC showed both had excess qualified assets and exceeded the 25:1 capital ratio requirements. The auditors found the companies to be financially sound.

In July of 1980, Reg Pointe, then an auditor in CCA, wrote to the President of FIC and clearly pointed out to the company that the regulators did not agree to accepting mortgages which had been negotiated outside the mortgage guidelines.

In September of 1980, Pointe again wrote to the companies and outlined the maximum uninsured mortgage quideline for each company. At the Code Investigation, Pointe was examined by Wittmann about an examination of AIC conducted by Bert Eldridge, an auditor in CCA as follows:

> Q. Then he does an analysis in Associated and says that four of the loans exceed Kallir's maximum loan figure, correct?
>
> A. That's right.
>
> Continuing:
>
> Q. You basically say that the proposal is not acceptable?
>
> A. That's right.
>
> Q. And that you have discussed it with the Superintendent -- I am referring to page 308 -- and "We are not at this time prepared to accept it."
>
> A. That's correct.

Q. You also had a meeting in consequence of that and you memorialize that to your file at page 309, June 24th, 1980?

A. Yes.

Q. Mr. Darwish was there?

A. He was.

Q. Mr. Kallir was there and Mr. Marlin?

A. That's right.

Q. The mortgage guidelines were not changed or modified from the point of view of the regulators, were they?

A. Not at that point.

Q. Once again, you are into advising them to make a written submission if they want them changed or modified?

A. That's right. (TR. Vol. 153, Page 28485)

In May of 1980 the matter of misleading information brochures arose. The Federal Department of Insurance, who conducted inspections on behalf of CDIC, advised CCA that from time to time they received inquiries from depositors in FIC and AIC who were under the impression their funds would be insured by CDIC. The letter stated: "I believe your office is in a better position than the federal department to put an end to this type of misleading practice."

In October of 1980, lengthy correspondence and discussions took place between FIC and AIC and officials of the Superintendent of Insurance regarding the wording on contract application forms, pamphlets, and brochures. The companies proposed a statement "both companies are registered under the ICA (Alberta). Assets equal to 100% of the certificate liabilities are maintained on deposit with a government approved custodian." Although controversy centered around the use of the word "guaranteed", the companies were allowed to use it because their competitors did. The auditors, and Darwish, allowed the phrase to be used, provided the words "a Canadian chartered bank" were substituted for "government approved custodian". At this time, the auditors and the Superintendent of Insurance were of the opinion that assets equal to 100% of the certificate liabilities were not on deposit, because they were concerned that a portion of the assets deposited with a United States branch of a Canadian chartered bank did not qualify. However, they allowed the statement to stand, and this statement, with some minor modification, continued to be approved and used by the companies over their remaining life.

In March of 1981 the regulators examined the December 31, 1980 financial statement of FIC, and observed that if property values were written down to appraised value the company would not meet the minimum requirements of the Act in respect to the section 8 tests.

In October of 1981 the auditors completed FIC's annual examination for December 31, 1980 and to June 30, 1981. In a report written by Eldridge, the following concerns were noted:

(a) Investments were made in unqualified assets not in accordance with the ICA.

(b) Deficiencies were noted in qualified assets on deposit as assets in a U.S. depository were not recognized by the auditors as meeting the requirements of the ICA.

(c) The borrowing to capital ratio was 65:1, substantially in excess of the approved 25:1 figure.

(d) Changes in valuation methods regarding marketable securities were noted which the auditors felt did not meet the requirements of the ICA.

(e) Decline was noted in the book value of bonds.

(f) It was determined that FIC had 64 mortgages three or more months in arrears totalling $12,273,239.

(g) Mortgage lending practices were not in accordance with the "agreed" guidelines.

(h) The previous year, the administration and sales cost expressed as a percentage of outstanding certificates was 2.45%. The company had to earn over 4% per annum more than the interest and additional credit amounts to be paid to certificate holders, to cover the cost of its funds and this would become more and more difficult.

(i) There was a matching problem.

(j) There was improper completion of sales application forms, showing additional credits as part of a fixed or guaranteed investment rate, rather than a discretionary payment.

(k) The market value of the company's assets was not sufficient to meet its liabilities.

Eldridge suggested prior to the Superintendent taking action, the Department, as a regulatory body, adopt a standard policy for all financial institutions under its administration which were affected by the unforeseen high interest rates of the day. He considered this to be an utmost priority of the Department. It was pointed out the company was getting further away from the original concept of an investment contract company due to its volume of single pay certificates. The President of FIC and AIC, h[illegible] acknowledged this and had looked into the possibility of moving one of the investment contract companies to the Loans Act. This would have enabled the new company to obtain deposit insurance. Eldridge recommended the department consider the future of the ICA and the nature of the companies licenced under it. The facts found in the FIC examination were brought to the attention of the Superintendent of Insurance on October 23, 1981.

In January of 1982 the regulators examined the monthly financial statements of FIC up to November 30, 1981. It was found that the company had valued its stocks in accordance with Section 29(2) of the ICA but had not obtained the approval of the Superintendent to do so.

Section 29(1)(e) of the ICA states:

> (1) In any statement or balance sheet to be filed with the Superintendent under this Act, an issuer may value its assets as follows:

> (e) stocks, at the book value not in excess of the cost to the issuer and in the aggregate not in excess of the market value at the date of the statement.

Section 29(2) of the ICA states:

> (2) Notwithstanding subsection (1), if any assets consist of securities whose market values are unduly depressed and in respect of which companies registered under the Canadian and British Insurance Companies Act (Canada) have been authorized to use values in excess of those market values, the assets may, with the approval of the Superintendent, be valued as authorized under that Act.

On February 24, 1982 the Superintendent of Insurance wrote to the President of FIC and AIC and insisted stocks not be valued in excess of the aggregate market value. If valued at market, the company was in a deficit position. On March 1, 1982 the regulators outlined their research into how the company had valued stocks in previous years. For the 10 years ending December 31, 1980, only in 1973-74-75 had the alternate method of valuation under Section 29(2) been used. Otherwise stocks were valued at the lower of cost or market as set out in Section 29(1). On May 31, 1982 the Superintendent of Insurance again wrote to the company and stated that stocks had to be valued for financial statements at market value. The debate over valuation of stocks continued and the Superintendent of Insurance requested the companies refile the 1981 statements because they had used the averaging provision under Section 29(2) which was not allowed. On January 28, 1983 the companies wrote to the regulators and disagreed. Evidence from the Code Investigation indicated the matter was not resolved.

The reports prepared by Eldridge in August 1982 on the annual examination of FIC and AIC for the year ended December 31, 1981, and the interim statements since received showed substantial and major concerns and a beginning of deterioration in several areas that continued over the remaining life of the company. Eldridge reported that FIC, rather than having the required unimpaired capital of $500,000, in fact had a deficit of capital of $28,601,770. The deficit for AIC was $7,857,261. As FIC showed losses to June 30, 1982, in excess of three million dollars, and AIC in excess of $800,000, it was recommended that the companies be required to provide budgets and forecasts for the balance of 1982 and 1983. The companies did not meet the "gentleman's agreement" on the borrowing to capital ratio of 25:1. At June 30, 1982, AIC's ratio was 98:1 and FIC's 262:1. Eldridge recommended that a borrowing to capital ratio be legislated for investment contract companies, rather than a fixed capital base of $500,000. He pointed out that FIC in the six month period ending June 30, 1982, lost $3.16 million or six times the required capital base, and the failure of any one of the 29 large mortgages could jeopardize its entire capital base.

Eldridge pointed out that PGL had the two investment contract companies and PS&T which were operated in conjunction with one another. In 1981, the liabilities of the trust company, whose capital requirements rose proportionately with liabilities, decreased while the liabilities of the investment contract companies, whose capital requirements were constant, rose. PS&T was the only major trust company in Alberta to reduce its assets. Since the investment contract companies and PS&T used the same sales force, the sales force promoted deposits in the contract companies. Deposits in the investment contract companies did not require a corresponding increase in capital, regardless of the amount of deposits.

Another item noted by Eldridge was that administrative and selling expenses payable to PGL had not been recorded. If they had, the figures would have been much worse. The report stated, "This is a most serious matter and it results in the department being mislead (sic)". The report recommended the companies again be required to file quarterly audited financial statements rather than unaudited monthly statements which had been accepted in recent times.

Many mortgages were found to be in arrears and some were in the process of foreclosure. It was therefore recommended that appraisals be done on all property in inventory and all mortgages that were six months or more in arrears. As well, a reserve for bad debts was recommended. Given the state of the real estate market, Eldridge was not prepared to give a qualified opinion on the value of individual mortgages or real estate in inventory. Eldridge disagreed with this practice. As well, the second "gentleman's agreement" adopting mortgage lending guidelines approved by the Federal Department of Insurance was being violated regularly. By June 30, 1982, 204 mortgages were three months or more in arrears in FIC and AIC.

Late in 1982, the question of reserves also became a subject of discussion between the then Superintendent of Insurance, Ron Kaiser, and FIC and AIC. The auditors were concerned that reserves were not sufficient. The ICA required reserves to be maintained for the repayment of outstanding contracts in an amount which, together with future payments to be received under those contracts and interest to be earned on those reserves, calculated at a rate not to exceed that approved by the Superintendent of Insurance, would provide funds to repay the purchaser of the contract the agreed upon amount when it matured. The companies continually sought to use the highest possible interest rate to calculate these reserves, so as to reserve the lowest amount of assets. The auditors felt that the contract should be reserved at an interest rate reflecting the rate agreed to be paid in the contract, usually 4%. The companies wished to reserve at a rate reflecting the payment of the discretionary additional credits as interest, which in some cases would be three or even four times the "face rate". This was another continued controversy that at times meant a dispute of many millions of dollars as to whether or not the companies complied with the ICA that remained unresolved throughout the life of the companies.

On January 28, 1983 the President of FIC and AIC, wrote Kaiser with respect to the 1981 audit. Kaiser had directed the company to refile the 1981 statements because they had used an averaging provision to value marketable securities under Section 29(2), which was not allowed. The companies had been advised in February 1982 that using this system was not permissible. FIC and AIC were of the opinion that the 1981 statement in fact reflected the complete information, including the results which did not use the averaging system. The auditors continued to press their superiors to have FIC and AIC refile the 1981 statement and drafted a letter to this effect, however, it appears the letter was never sent.

In July of 1983 a memorandum was sent from the Deputy Superintendent of Insurance to the Superintendent of Insurance advising this matter was still outstanding and needed to be resolved. In November of 1983 the auditors advised the Superintendent of Insurance this item was still outstanding and in December of the same year a draft letter was formulated advising the President of FIC that rather than pursue the request of the Superintendent in his letter of December 9, 1981, to have statements refiled, the value of the stocks referred to was being written down by an additional $2.5 million for 1981. This draft letter was never sent.

In October 1983, the report on the annual examination of FIC and AIC for the year ending December 31, 1982, and the interim statements to July 31, 1983, were prepared by Allan G. Hutchison, C.A., a department auditor, and forwarded to Eldridge, who had been promoted to Acting Director of Audits. Those reports showed continuing and alarming deterioration in the financial condition of the investment contract companies, in all of the areas that had concerned Eldridge the previous year. A capital deficiency for FIC of $39.4 million was identified as of December 31, 1982, although that had improved to a deficiency of $31.7 million by July 31, 1983. None of the section 8 tests were met; the deficiencies of each financial test was more than $20 million. It was noted that a borrowing to capital ratio was now an absolute requirement. FIC had liabilities to investment contract holders at June 30, 1983, in the amount of $230 million; the capital requirement of $500,000 allowed FIC to operate legally with a borrowing to capital ratio of 460:1.

Regarding mortgages, the report stated that there was clearly no attempt to meet the "gentleman's agreement" to adhere to Federal Department of Insurance mortgage guidelines; large mortgages continued to be taken. Again, mortgages continued to be valued by capitalizing outstanding interest which increased the value of the mortgage if the mortgage was in arrears. If these arrears were deducted rather than added to the value of the mortgages, the losses for the year would have been increased by $12 million, which the report called "staggering". The reserve for bad mortgage debt was considered grossly inadequate, given that on June 30, 1983, 63.7% of FIC's mortgages were over three months in arrears or in foreclosure. Losses for 1982 were $4.3 million, with an additional $2.5 million loss up to July 31, 1983. The company had therefore in the 18 month period reviewed lost over 13 times the required statutory capital of $500,000. AIC's report showed all of the same concerns, with its capital deficit being $10.6 million at June 30, 1983. Although it was a much smaller company, with liabilities to investment contract holders of $67 million, the conclusion was that it was probably in worse financial condition than FIC. The important recommendations to the now Superintendent of Insurance, Saleh, were that the company be made to comply with the section 8 tests, failing which he should consider making a Special Report to the Minister to require action under the ICA. Secondly, because of the serious doubts about the value that mortgages and real estate (most of which had been acquired by foreclosure) were carried on the books of the company, appraisals on all real estate and mortgages in excess of $250,000, six months or more in arrears, on non-income producing properties was recommended. Under the ICA, such an appraisal could be ordered and could be used to give auditors current values to calculate the real worth of the companies at year end, rather than accepting the questionable values placed on these assets by the companies. Eldridge concurred in Hutchison's recommendations and indicated in covering memoranda that action on the part of the Superintendent was clearly required.

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(3) Regulatory Events for Time Period Jan. 1/84 to Dec. 31/84

This period of time is critical to any review of the regulatory history of FIC and AIC. During the year, all of the shortfall identified by the regulators in the companies' operations reached a crisis level; as well, the companies began to undertake transactions on a desperation basis to save parts of the Principal

Group that were under the most extreme attack. Darwish, who was for a lengthy period of time the Superintendent of Insurance, in charge of the regulation of these companies, and who had involvement with them throughout his career with the Alberta government, gave testimony at the Code Investigation that his experience taught him to recognize a pattern of deterioration in the activities of a failing financial institution. The pattern he saw, in summary, was as follows:

> "A. I did, over the years I noticed a pattern. I used to talk to Reg Pointe about it. He was my assistant at the time.
>
> What we would find is that we would often find companies were having trouble with their accounting records. They would get behind. The excuse would be given that there is a tremendous workload or we have got staff problems.
>
> Then the next thing we would note that the financial statements would be coming in late. Then we would note that there would be financial transactions that they would enter into that they just normally wouldn't do in the ordinary course. They were, quite a bit, window dressing because they were in financial bad shape.
>
> When we would start to look into those matters, of course, we would get the promoters of the company agitated, which is understandable because it is a traumatic experience for an owner at that time, and they would complain often to the government.
>
> So that was -- well, actually, the final step would be that some of these people would take steps that they

> ordinarily wouldn't, desperate steps, sometimes even illegal steps. So there was a pattern there."

He then gave the following answer:

> Q. In 1984, did you see any of these same symptoms in the FIC and AIC problem?
>
> A. I did. I had also just previously seen them in the Paramount problem too. (TR. Vol. 138, page 25607-8)

Any observer of the events of which the Alberta regulators became aware in 1984 would have to agree.

On January 4, 1984, Saleh wrote to Marlin, setting out the concerns with the annual examination of FIC for the year 1982 which I have earlier summarized in this report. He stated:

> "In view of the seriousness of FIC's financial situation I am inviting you and your company representatives including your accountants to attend a meeting in my office on Tuesday, January 17, 1984, at 9:30 am for the purpose of making your representations with respect to:
>
> (a) Capital impairment of FIC.
>
> (b) The continued losses incurred by the company and immediate injection of permanent capital of at least five million dollars required to justify the company's continuance in business (assuming no further adjustments to your statements are made).

> (c) Budgets and operational forecasts for the year 1984 and the years beyond.
>
> (d) The immediate return to Canada of the U.S. securities held in New York in contravention of the Act.
>
> (e) The failure of the company to follow the mortgage guidelines brought to its attention several years ago. Also the requirement to substantially increase the reserve for bad debts in view of the significant amount of mortgage foreclosures and mortgage arrears.
>
> (f) Other concerns raised by our auditors on their 1982 annual examination and the resolution of violations still existing from the 1981 statutory audit, all as outlined in the attached Auditor's Comments."

On January 10, 1984, Hutchison, the auditor who conducted the 1982 annual review, wrote an update memo to his supervisor, Eldridge, that was in turn brought to the attention of Darwish, and through him to Saleh. Hutchison pointed out that two million dollars was paid by FIC to PGL in repayment of a subordinated note without notice to the Superintendent, and further that there were substantial concerns about the real estate and mortgage portfolio of the company. The value of foreclosed real estate during the year ended November 30, 1983 had increased from $6 million to $18.8 million. The mortgage portfolio had deteriorated rapidly, with 71.3% of the entire portfolio in arrears, 42.9% of the portfolio in foreclosure proceedings, and accumulated arrears on the mortgages continuing to be capitalized rather than expensed in an amount of $16.5 million or 16.4% of the entire value of the mortgage portfolio.

In reply to Saleh's demand for a meeting, Marlin challenged all the concerns raised in the 1982 annual review, stated the findings were false, but agreed to a meeting on January 25, 1984.

One of the additional concerns of the 1982 review related to the value placed on certain corporate bonds of Carma Ltd., Daon Development Corp., and Nu West Group Ltd., all western Canadian land development companies who had defaulted on their bonds. The claimed value for the portfolio was $1.25 million for AIC and $4.15 million for FIC. There was no market for the bonds. FIC and AIC took the position that the bonds should be valued at an average between the last bid and the last asking price posted, when there was a market. The audit staff believed that if there was no market, there was no market value. The company argued that their valuation technically complied with the section in the ICA dealing with valuations, even though there was clearly no real value in the bond portfolio. It was also clear that there was no right for the Superintendent to obtain an appraisal of bonds under the ICA, unlike the Trust Companies Act. There was no further attempt to resolve this problem, and the bonds were later sold in an intercompany transaction within the Principal Group.

The meeting demanded by Saleh on January 4, 1984, took place on January 25, 1984. Those attending were as follows: the CCA - J. Barry Martin, Deputy Minister; J. Darwish, Assistant Deputy Minister; Tewfik Saleh, Executive Director and Superintendent of Insurance; B. Rodrigues, Deputy Superintendent of Insurance; B. C. Eldridge, Senior Auditor; A. G. Hutchison, Auditor; R. Pointe, Director of Trust Companies; FIC - Ken Marlin, President; Archie Campbell, C.A.; Lynn Patrick, Vice President and Legal Counsel, PGL; Christa Petracca, Vice President, PGL.

Strangely, CCA officials were advised prior to the meeting by the Deputy Minister that they should listen to the submissions of FIC officials and not enter into any discussion with them about those submissions. FIC officials stated:

(a) 1983 audited financial statements would be better and would show a profit.

(b) PGL had been repaid the $2 million subordinated note because that note had been given to cover a decline in the market value of securities, which had been recouped. They did not deal with the problem of substantial deterioration in real estate investments, or relate that to the repayment.

(c) There was no answer to the concerns about the mortgage portfolio, but the companies pled for time.

(d) Additional capital was not offered. However, and for the first time, the suggestion was made by Marlin that if additional capital was required, the companies could cease to accrue additional credits to certain contract holders which would result in an immediate increase in capital of $24 million. In other words, the companies would cease to accrue on their books the additional credits over and above the 4% contractually required to be paid on the contracts, but the holders of the contracts would not find out until their contracts were redeemed some considerable time in the future.

(e) Discussion was presented concerning the valuation of the disputed bonds, but the personnel from CCA did not accept the explanation as being sensible.

Regarding the value of the corporate bonds, the Federal Department of Insurance, who regulated, among other things, trust companies on behalf of CDIC, advised one of the auditors that in their view, the corporate bonds of Carma Ltd., Daon Development Corp., and Nu West Group Ltd. would be appropriately valued at 30¢ on the dollar.

On February 24, 1984, Pointe, the Director of Trust Companies of CCA, received a confidential letter from the Federal Department of Insurance, outlining some substantial concerns. These concerns may be summarized as follows:

(a) The mortgage portfolio of PS&T was 74.8% in arrears, and the interest on arrears continued to be capitalized;

(b) PS&T held 36 properties with a book value of eight million dollars obtained as a result of foreclosure which did not appear to be readily marketable;

(c) PS&T was heavily mismatched, as a result of a policy of issuing short-term deposit certificates but investing in long-term investments;

(d) If proper reserves for bad mortgage loans and loss in value of real estate were set up, the borrowing to capital ratio would have been 41.8:1 and the borrowing base would have been negative without the subordinated notes. If the securities portfolio was also revalued to market, the borrowing to capital ratio would deteriorate to 92:1. The Federal Department of Insurance indicated that it was going to request conversion of the subordinated loans into permanent capital, injection of $2 million in additional capital, development of a plan for disposing of long-term bonds and achieving better matching, and requiring the company to appropriately reserve for losses on its mortgage portfolio and real estate portfolio, which the Federal Department of Insurance hoped to achieve by causing appraisals to be made of the properties mortgaged or held.

That information was shared by Pointe with the other personnel in CCA regulating FIC and AIC as well as PS&T. The audit staff, of course, were common to the regulation of investment contract companies and trust companies, in any event.

In order to obtain a proper evaluation of the mortgages and real estate held by FIC and AIC, and in response to the request of the auditors in the 1982 annual review report, some limited appraisals of selected real estate of those companies were undertaken by CCA. This was to allow revaluation of the properties appraised, as was provided by the ICA. During January and February, as these appraisals were developed, they showed an alarming trend. On one piece of property, the appraised value was only 41% of the book value of the mortgage, although FIC was still accruing interest at 22% per month in the amount of approximately $13,000/month, in addition to the capitalization of that mortgage. Another property was appraised at 25% of the book value of the mortgage. It must be remembered that these mortgages were to have been limited to 75% of the value of the properties mortgaged when they were taken out.

On February 24, 1984, Saleh prepared a draft memorandum to Martin on the financial condition of FIC and AIC. Both companies were deficient in unimpaired capital and approximately 63% of the mortgages were three months or more in arrears. He said, "Having considered our auditors' reports and the appraisals obtained so far, it appears that I am obliged under section 37 of the Investment Contracts Act to make a special report to the Minister pursuant to subsections (c), (d) and (e) of the said section." Saleh did not forward the memo because he thought the first step was an independent investigation. However, on February 29, 1984, Martin wrote to Darwish and requested no further appraisals be conducted until he gave further notice, as he was discussing the matter with the Minister and the appraisals were confirming the common knowledge of the highly distressed market values of real estate in Alberta. At the Code Investigation, Darwish indicated his surprise at this direction from Martin, as he stated he had never before been denied the opportunity to obtain appraisals.

On April 4, 1984, Eldridge reported to Darwish with a copy to the Superintendent of Insurance stating that with respect to the appraisals that had been completed on properties owned by FIC, AIC, and PS&T, the appraised values were about one third of book value, for an average write-down of 65%. In spite of this, no further appraisals were obtained on properties owned by the investment contract companies or, indeed, by PS&T, through CCA. No other method was available under the ICA to revalue real estate or real estate backed mortgages.

An amendment to the ICA requiring a 20:1 borrowing to capital ratio had been proposed for the spring sitting of the Legislature in 1984, however, it was not proceeded with as it was not considered to be urgent. There is no indication that it was strongly supported by officials of CCA or requested as urgent by the Superintendent of Insurance.

At this point, CCA became aware of a significant transaction, referred to in the Code Investigation as Transaction #1, which was very alarming to them. The first awareness of that transaction was in a letter dated March 30, 1984, to Pointe, Director of Trust Companies, from the President of PS&T, John Cormie. He advised that as a result of the concerns of R. T. Page of the Federal Department of Insurance, which had been communicated to Pointe on February 24, 1984, PS&T had concluded that "The long term strategy required to successfully market or develop a real estate portfolio is incompatible with a Demand Deposit-Taking Institution". Therefore, he advised that PS&T's joint mortgage partners, (FIC and AIC) had paid out PS&T's large joint mortgages and real estate holdings by payment to PS&T of $23,245,129, which represented the book value of those properties to PS&T. The payment was made in cash. The properties involved included interests in 19 mortgages and 4 properties. By the time of receipt of this letter, Pointe had been made aware that PS&T had been warned that if it did not respond to the concerns of the Federal Department of Insurance, it was likely CDIC would send a formal report to the company pursuant to Section 25 of the Canada Deposit Insurance Corporation Act. This would be a first step towards cancelling PS&T's policy of deposit insurance with the CDIC, and in turn cause it to lose its registration as a trust company in Alberta.

On April 10, 1984, Pointe formally brought the transaction to the attention of Saleh, and indicated he thought it might be in contravention of section 138 of the Trust Companies Act, although John Cormie of PS&T was firmly of the view it was not a sale and therefore did not contravene that section. It is interesting to note that the company later provided an internal legal opinion (which was prepared after the transaction) that it was not a sale, giving as the reason that FIC had perceived risk to its security position under the mortgages, and had therefore tendered the book value of those mortgages to PS&T to improve its position. L. A. Patrick, PGL's legal counsel, who prepared the opinion, stated "As the parties are apparently not ad idem as to the unilateral action of FIC, the earmarks at law of a "sale" are not present . . . " This opinion, after translation, suggests somehow that PS&T

unwillingly accepted $23.25 million dollars for assets that were undoubtedly worth less than half of that amount. Mr. Patrick, in testimony at the Code Investigation, denied that this was intended as an opinion or for release outside the company and said it did not represent his opinion. It was simply a memorandum outlining the basis for an opinion being requested of him by company officials.

Darwish, because of his long experience with FIC and AIC became highly alarmed upon learning of transaction #1. It prompted him, along with his knowledge of the other shortfalls in the operations of FIC and AIC, to draft a memorandum which he gave to Martin, with the request that it be forwarded to the Minister, Constantine Osterman, and that he be allowed to meet with the Minister.

A 20 point summary of his concerns with the operations of FIC and AIC was attached and is reproduced here:

> 1. The company completely ignored guidelines sent to them setting out limitations on the size of investments. They proceeded to make huge investments without any regard whatsoever to the amount of capital they had and the discussions that were taking place between them and our department at the time.
>
> 2. They placed huge mortgages on undeveloped, speculative real estate.
>
> 3. They consistently pay higher interest rates in order to attract deposits than do other companies and therefore have to invest in more speculative types of mortgages and real estate in order to earn for themselves sufficient income to pay these high rates.

4. The present condition of their foreclosed real estate and mortgage portfolio is one of the worst, if not the worst, that the Audit Unit has examined.

5. The company continues to accrue interest on mortgages that haven't received a payment, in some cases, for over two years.

6. At the same time as accruing the above-noted interest, the company sets up grossly inadequate allowances for bad debts. Thus, the combination of item #5 above and this item overstates the company's profits. (See item #18 following)

7. At the time when the company seriously needed permanent capital, they had the effrontery to withdraw $2 million from their company to pay off a "so-called" subordinated note to their parent company thus further exposing investment contract-holders (the public) but at the same time protecting their own interests in the parent company.

I use the word "effrontery" because at the meeting that we held with company officials, they stated that the $2 million was only put up during a time of depression in the securities market and now that this depression was gone, they felt entitled to withdraw the $2 million. They did not even mention the fact that their mortgage and real estate portfolio was many times worse than any drop in the securities market.

In essence, we have a serious need for capital because of bad investments coupled with withdrawal of capital which, of course, makes the situation far worse than it was.

8. Because of the high interest rates that the company offers, it attracts many thousands of Albertans as investors

but unfortunately, these investors do not have the protection of the Canada Deposit Insurance Corporation. Should this company fail, the effect on the confidence in financial institutions in Alberta would be serious.

9. I was shocked at the meeting with company officials when they indicated on a number of occasions that one way in which they could solve their financial problems would be to pay their contract-holders only the guaranteed amount (4%) and not pay them the additional credits that had been held out to them, but not guaranteed, in the amount of 7% or 8%. They pointed out that if they did this, they would immediately generate a substantial amount of capital. That they even contemplate such a move is irresponsible.

10. The appraisals to date reveal that this company is not simply faced with an unfortunate situation relating to investments in mortgages at a time when the economy is depressed and real estate values have weakened, but that imprudent and speculative investments have been made which reflect unfavourably on management.

11. Other companies in the mortgage and real estate business, such as Daon, Carma and Nu West, must value their properties at market. This has caused all these companies to default on various debentures and notes. In order to obtain financing, they must deal with their bankers or the public marketplace. No banker or investment dealer would lend funds on the basis of inflated values for assets. Thus, there is a third party balance to financing these companies. They are not blessed with unlimited cash flow.

It is for this reason that administrators of Acts relating to financial institutions must ensure that proper valuations are used. Failing this, more and more investors place money with the company when they shouldn't. There is a heavy duty placed on an administrator. That is why Provincial and Federal Governments have auditors to analyze the financial statements from the point of view of the investing public, not the shareholders.

12. We have learned of a non-arm's length transaction whereby $9 million worth of accounts receivable have been sold by the parent company of First Investors to First Investors. Thus, First Investors gives up $9 million and the parent company gives up accounts receivable. I am concerned about this transaction. If the accounts receivable were good, why would they not stay with the parent company? Is First Investors' cash being used for the benefit of the parent company?

13. This group of companies, which includes First Investors, Associated Investors and Principal Trust, does not hesitate to use the name of the Superintendent of Insurance when they deal with their contract holders. An example is correspondence that Associated Investors directed to a Mr. Robbins - copy attached.

You will see that throughout the letter of February 23, 1984, there are four references to the Superintendent of Insurance and one reference to a deposit held by a Canadian chartered bank and there is even a reference to their independent auditors. In the letters of February 1, 1984, and November 8, 1983, are references to the deposit being held with the Canadian chartered bank. As we know, this is incorrect.

The references to the Superintendent of Insurance are probably a contravention of Section 46 of The Investment Contracts Act and if they aren't, they certainly come very close to it.

The February 23, 1984, letter is of real concern when one realized the serious financial problems that Associated Investors has.

14. I have referred to other companies in the Principal Group because they are all linked together, they are owned by the same person, and many of the appraisals done to date are on properties in which the two investment contract companies and the trust company all have a share in the investment. Thus, the appraisal deficiencies affect all three companies and in a material way.

Should one of these companies fail, because they are part of a pyramid, it is conceivable that all will fail or be seriously affected.

15. On January 4, 1984, the Superintendent wrote a letter to FIC based on the auditor's report. This was followed by a meeting with company officials, at which department officials were instructed not to discuss items but to listen only. As far as I know, nothing further has been done.

I am concerned that a situation similar to what developed with Paramount appears to be developing with F.I.C. We should be careful we don't repeat this scenario.

16. This company's problems are more far-reaching than simply the sale of investment contracts. The company's contracts are

deemed under the Trustee Act to be an acceptable investment for a trustee. Before the company can comply as a trustee investment, however, it must be approved by the Securities Commission. In my opinion, this company should not be allowed to continue as a trustee investment. This decision is, however, up to the Securities Commission. Thus, we should advise the Commission of our concern about the financial stability of First Investors.

17. The financial statements of F.I.C. state that "Real estate obtained in satisfaction of debts", in the amount of $9,219,518, is valued at the lower of cost or net realizable value. The appraisals obtained to date indicate this is not correct.

18. The following is a calculation of First Investors unimpaired capital as at November 30, 1983:

Unimpaired capital as calculated by First Investors		$2,910,000
Deduct: Differences between book value of mortgages ($7,900,000) and appraised value of underlying security ($2,700,000)	$5,200,000	
Deduct: Difference between book value of real estate ($5,000,000) and appraised value of real estate ($2,100,000)	2,900,000	
		$8,100,000
Impaired Capital		($5,190,000)

As may be seen, First Investors is in a seriously impaired position. The above calculation only gives effect to the appraisals that have been completed and I think that it is safe to say that other appraisals will also result in substantial reductions in values with the attendant increase in the capital impairment.

19. The company continues to accrue interest on mortgages that are in arrears. This was referred to on page 57 of the audit report where it states:

> "FIC at June 30, 1983 has capitalized $12 million in arrears interest to mortgages and it was considered questionable whether the value of the real estate backing the mortgage was sufficient in all cases. e.g. the carrying value of the asset is increasing while the market value of the real estate is decreasing.
>
> If FIC expensed arrears interest on delinquent loans rather than capitalizing its losses would increase by a staggering $12 million."

Generally accepted accounting principles require that proper allowances be made for the possible loss on the loans in arrear.

If First Investors used the same policy as the Bank of Montreal, it would provide an allowance for interest on loans 6 months or more in arrears. The total amount, according to information provided to me by the Audit Unit, would be $16,400,000 as at November 30, 1983. At that date the

> allowance for bad debts established by First Investors was $920,000, some $15,500,000 less than what would be required.
>
> Applying the same standard as the Bank of Montreal (and this is a reasonable standard), the impaired capital shown in item #17 above would be increased by approximately $7,500,000.
>
> 20. Accepting the company's unimpaired capital of $2,910,000, the ratio of capital to liabilities would be approximately 77 to 1. A ratio such as this for a company that essentially sells instruments similar to a trust company G.I.C. is very serious in itself. Making adjustments for the overstatement of the value of assets makes the situation completely unacceptable.
>
> In my view, the company does not meet the capital requirements under the ICA and there exists a state of affairs that is or may be prejudicial to the interests of its investment contract-holders.
>
> We should, therefore, ask the company to immediately rectify the capital impairment, consider taking such other steps as may be necessary such as curtailing or stopping the sale of investment contracts to the public, and discuss the need for the appointment of an administrator. The Securities Commission should also be advised of our concern with our recommendation that F.I.C. and A.I.C. be dropped as 'trustee investments' under The Trustee Act.

Darwish was recommending serious consideration be given to remedies under the ICA, including the forwarding of a Special Report to the Minister, the appointment of a receiver and manager, or curtailment of the licences of FIC and AIC. His view of transaction

#1 was clear. He stated "I assume Principal Trust has responded in this way so as to put their house in order for the Canada Deposit Insurance Corporation (CDIC). By doing so, they have abused the provincial investment contract companies, presumably because it was the path of least resistance."

This memorandum was presented by Martin to the Minister, in a meeting. Martin stated in his testimony at the Code Investigation that he agreed with the contents of the memo, and did not doubt Darwish's ability to assemble facts. The Minister did not read the memo, but expressed the same confidence in Darwish's ability. However, the Minister, rather than reading the memo, telephoned Darwish on the 30th day of April 1984 and advised him that the matters raised in the memo were no longer his concern in his new position and strongly reprimanded him for forwarding it. In the end result, it is clear that the forwarding of this memo caused Darwish to lose his position.

Both Martin and Osterman stated repeatedly in testimony throughout the Code Investigation that they already knew the information contained in Darwish's memorandum by the time it was presented, and it was therefore not necessary for it to be presented, although Osterman did indicate the specifics of the information were not clear to her.

As a result of concern about transaction #1, Saleh wrote to Marlin on May 11, 1984. Incidentally, it was pointed out in that letter that the financial statement for the year ending December 31, 1983, for both FIC and AIC had only been submitted on May 8, 1984, although by the statute they were due on March 31, 1984. This was the first time statements of the company were delivered later than the statutorily required time. That letter, which was strongly worded, demanded a meeting with Marlin, his company's representatives, and his external auditors to take place on Tuesday, May 29, 1984, at 9:30 a.m. The matters to be discussed, as quoted in the letter, were as follows:

> 1. The transaction with PS&T should be immediately reversed (this referred to transaction #1).
>
> 2. All subordinated notes held by the two companies as of December 31, 1982, in the amount of 8.2 million for FIC and 1.7 million for AIC be converted into permanent capital.
>
> 3. Injection of capital into both FIC and AIC over and above the conversion of the subordinated notes to provide for the losses on mortgages and foreclosed real estate which is estimated to be 52 million for FIC and 20 million for AIC. If you disagree with our assessment, an immediate injection of capital in the amounts of 25 million for FIC and 10 million for AIC is required as an interim measure.
>
> 4. Acceptable borrowing to capital ratio of 25:1 maximum should be complied with by both companies. The ratio at December 31, 1982, of 92:1 for FIC and 105:1 for AIC (based on your own capital figures) are incompatible with the practice of deposit taking institutions.
>
> 5. The two companies appear to continue to accrue and capitalize interest on mortgage loans in arrears in excess of the original equity in the properties securing the loan as currently appraised. This practice artificially inflates earnings and should cease. Accrued interest on loans delinquent for 90 days should be covered in the Allowance for Bad Debts.

About the same time, Darwish had become concerned about interest rates being advertised by "Principal Group" and had made a telephone call which led him to believe that misleading information about the security of investments in the investment contract companies was being given out by Principal Group sales people, including statements to the effect that investment contract holders were fully guaranteed that their investment would be paid because 100% of all assets required to pay out those investments was on deposit with the Royal Bank, which would pay out investors if there was any difficulty. Darwish asked George Blochert, the Executive Director of Regional Services within the CCA to conduct an investigation of the various regional branches of the Principal Group to ascertain whether misleading information was being given out. When Martin learned of this on the 16th of May, he stopped the investigation, stating in a memo to Blochert,

> "It has just come to my intention that inquiries are going to be initiated at the regional level into the sales practices of the above companies. Inasmuch as the financial status of these companies is now receiving my attention, and that of the Minister, I would request that your instruction of May 16, 1984, be immediately withdrawn and no further action be taken on this matter unless under my specific instruction."

In his testimony at the Code Investigation, and in my interview with him, Martin indicated that he felt there was substantial risk that such investigation could become public, jeopardizing the position of FIC and AIC at a time when he and the Minister did not want to jeopardize the position of any Alberta based financial institution in any way. The Deputy Minister did contact Marlin and advise him of the circumstances surrounding the proposed investigation. Marlin advised that he would look after it by advising his sales staff to not engage in such practices.

On May 28, 1984, the Priorities, Finance & Coordination Committee of the Alberta Government met. At this meeting a Task Force was set to review the impairment facing financial institutions governed by provincial statutes. The Task Force would report to the Priorities Committee. This Task Force was chaired by the Minister of CCA, Osterman; and its members included the Provincial Treasurer, Hyndman; the Attorney General, Crawford; the Minister of Municipal Affairs, Koziak; the Deputy Provincial Treasurer, McPherson; and the CCA Deputy Minister, Martin. The Committee was to bring forward a plan of action, if necessary.

Evidence at the Code Investigation indicates the status of AIC and FIC did surface. There was continuing concern but never information that suggested insolvency or the need for direct government action such as suspension of registration.

On May 29, 1984, Saleh received a letter from E. P. Jewitt, C.A., the Deputy Superintendent of Brokers for the Province of British Columbia. Jewitt stated that he had just discovered that although FIC and AIC were required to file quarterly statements with his department under section 17 of the Investment Contracts Act of British Columbia, the last such quarterly statements received for these companies was for the quarter ended December 30, 1978. He had received the year-end statement of the company for December 31, 1983, and was substantially concerned because of a possible shortfall in capital of FIC of $17,793,114, and in AIC of $3,003,831. He believed that if the companies were forced to sell their assets, a greater shortfall would occur, indicating that the assets were felt to be substantially overvalued. He wanted to obtain further information concerning meetings with the principals of the companies which he understood were forthcoming with Saleh.

On June 7, 1984, Eldridge reported to Saleh concerning the statement of assets, certificate of liabilities, and reserves of FIC and AIC as of December 31, 1983. The statement of assets was filed pursuant to Section 26(1) of the ICA.

Eldridge had several serious concerns. In the past the statement of assets had been filed as an audited statement by the external auditors of the investment contract companies. The December 31, 1983 statement of assets were unaudited, prepared by the company, and forwarded together with some notes prepared on the letterhead of Touche Ross & Co., the external auditors of the investment contract companies, but some of the other important notes that had appeared in the audited financial statements were omitted. Eldridge indicated that their examinations in the past centered around the statement of assets, rather than the balance sheet attached to the audited financial statements, because the statement of assets was filed in accordance with the requirements of the ICA. The balance sheet would be filed in accordance with generally accepted accounting principles for all companies, and was not the same. He detailed some very specific differences, and went on to state:

> "Would you please point out to the company that we cannot accept the unaudited statement of assets and instruct the companies to file an audited Statement of Assets without delay.
>
> These statements, with the attached notes on the auditors letterhead, unless in fact they have been authorized or approved by the auditors, are misleading. We should ascertain the position of the auditors and if they have not authorized the use of the statements in this form we should advise the company we consider this submission misleading or improper."

On June 11, 1984, Hutchison forwarded a memorandum to Eldridge in which he indicated that Christa Petracca, Vice President of Corporate Development for PGL, had informed him that transaction #1 was entered into because CDIC was completely unreasonable regarding the reserves required on owned real estate and mortgages, and the Superintendent of Insurance was much more reasonable. He also stated in that memorandum:

> "I am finding the staff of FIC and AIC (C. Petracca, John Cormie, and A. Campbell) increasingly more difficult to contact and obtain answers to my questions. Either they are very busy or they are reluctant to discuss this transfer."

As a result of Saleh's demand for a meeting in his letter of May 11, 1984, a series of three meetings was held centering around transaction #1 and other concerns. On the morning of June 15, 1984, a preparatory meeting was held at 8:00 a.m. with officials of CCA and CDIC officials but without departmental auditors. At 1:30 p.m. on the same day, a meeting was held with representatives of PS&T, FIC and AIC, officials and auditors of CCA, and representatives of CDIC. On June 19, 1984, another meeting took place between officials of CCA, including the departmental auditors, and officials of PS&T and FIC and AIC. On June 20, 1984, there was a further meeting attended by officials of CCA, including the departmental auditors, and officials of PS&T and FIC. During these meetings, which are summarized below, CCA received further and much more alarming information concerning the affairs of FIC and AIC.

During the meeting of June 15, 1984, the following persons were in attendance: R. M. Hammond, Federal Superintendent of Insurance; J. B. Sabourin, Manager of CDIC; Charles De Lery, Chief Executive Officer of CDIC; Denise Sicotte, Examiner for CDIC; Martin, Saleh, Pointe, B. Stone, Deputy Director of Trust Companies, and Darwish.

During that meeting, CDIC pointed out its concern if transaction #1 was reversed and the fact that would cause serious problems in the continued licensing of PS&T. It also indicated concerns about one company failing and causing the rest of the companies within PGL to fail. Saleh continued to insist that transaction #1 should be reversed. Hammond stated that CDIC did not want to take any steps against PS&T without letting the Alberta government know because it would clearly affect the other Alberta financial institutions, FIC and AIC. Martin stated that his Minister was fully informed.

The 2:00 p.m. meeting on June 15, 1984, included the following persons from PGL, representing FIC and AIC and PS&T - Marlin, Petracca, John Cormie, James Cormie, Lynn Patrick. Personnel attending from CCA were Martin, Darwish, Saleh, Pointe, Hutchison, Stone, and Hammond, Auditor, Federal Department of Insurance, represented CDIC. The Principal executives began the meeting on a confrontive basis, stating Saleh's letter was based on unreliable information, could create a panic situation among their clients, and could result in lawsuits against the department. During the meeting, Marlin and Petracca spoke about a number of proposed or pending transactions which would have a beneficial effect on the financial position of all companies within the Principal Group, but all governmental officials involved found they were described in such vague and uncertain terms as not to be of any assistance. What they did reveal during the meeting was that they were prepared to stop the practice of continual accrual of interest on mortgages that were in arrears. However, Petracca revealed that in order to offset this reduction in value of the investment contract companies' assets on their books, they had decided, on May 8, 1984, to cease declaration of additional credits on all single pay certificates maturing later than April 1, 1985. She stated that this would result in reduction of the liabilities in FIC alone of $11.8

million. This failure of declaration of additional credits would of course not become known to those holders of investment contracts until they redeemed them after April, 1985. Darwish became very upset during the meeting, and pointed out to Marlin that he believed that this was not proper. Marlin's reply was that there was no legal duty to declare the additional credits. Marlin also made it clear to the meeting and to Saleh in particular, that he was not prepared to put up any additional capital into FIC and AIC at all.

The June 19, 1984, meeting, which was a continuation of the earlier meeting of June 15, 1984, was attended by Marlin, and James Cormie on behalf of the Principal Group. From CCA, Martin, Darwish, Pointe, Saleh, Eldridge, Hutchison, and Stone attended. During this meeting, Marlin indicated that PGL was prepared to put up a $4.5 million subordinated note to FIC only as security against any actions that might be brought by contract holders against FIC regarding transaction #1. At the close of this meeting, Marlin provided Saleh with a letter dated June 19, 1984, as a formal reply to his letter of May 11. That letter directly met the allegations of Saleh, and suggested that the appraisal techniques used by the department, which were those used by the Federal Department of Public Works, were inappropriate, and would lead to reduced values and made it very clear that FIC disputed the criticism of transaction #1. It is interesting to note that the letter takes the specific position that a borrowing to capital ratio is not a requirement of the ICA and should not be, and that investment contract companies should be regulated like life insurance companies. It specifically states that FIC and AIC are being "erroneously looked at as if they are deposit taking institutions", and denies they should be subject to similar rules or similar regulations as trust companies. Regarding additional credits, the letter states,

> "It is certainly our wish to treat our contract holders on a competitive return basis, and a failure to do so would cause us to gradually lose our customers over a period of years; but we have no legal obligation to declare or guarantee additional credits at any particular rate on a specific certificate or series of certificates."

The final meeting, on June 20, 1984, included the following persons on behalf of PGL and FIC: Marlin, Petracca, John Cormie, James Cormie. Those attending from CCA included: Darwish, Saleh, Eldridge, Hutchison, and Stone. As well, Bruce Pennock, C.A., attended representing Touche, Ross, PGL's external auditor.

At this meeting, Pennock stated that in order to reach the mortgage reserve figures for FIC and AIC, Touche Ross obtained appraisals on 12 or 14 properties as well as retaining A. E. LePage to do a verbal evaluation of properties. Pennock indicated during the meeting that he had only received a copy of Saleh's letter of May 11, 1984, the previous evening and could not reply to it in detail. During the meeting, it was agreed that PGL would put additional capital into PS&T in the amount of $6.3 million in subordinated notes in the event the Superintendent of Insurance reversed transaction #1. This was after telephone discussions during the meeting between CDIC and PGL officials. There was no agreement to putting additional capital into FIC and AIC.

It is important to note the conclusions and recommendations of Hutchison, who at that time was in charge of conducting the annual examination of FIC and AIC, as a result of the deliberations in these meetings. They are as follows:

1. The public is being intentionally misled by FIC and AIC in their method of handling the non-declaration of additional

credits. I recommend that FIC and AIC be advised by the Superintendent to notify all certificate holders in writing whose certificates have had the additional credits suspended. In addition, I recommend that FIC and AIC advise all new customers that they have not declared additional credits on certain certificates during 1984.

2. Since R. Pointe requested that we perform an audit on PST in conjunction with our audit of AIC and FIC, I recommend he be asked to provide us with any documentation received from the company that is relevant to the audit. It is impossible to do a proper audit when information is not made available from the audit unit.

3. In my opinion the tendering of $23.5 million in mortgages from PST to FIC and AIC is prejudicial to the contract holders and the transfer should be reversed.

4. FIC should be required to comply with T. Saleh's memo dated May 11, 1984 and inject additional capital into the contract companies.

5. Since it appears that PGL officials are not providing copies of very pertinent departmental letters regarding the financial condition of FIC and AIC to their external auditors even when requested to do so, I recommend that the Superintendent be advised to send copies of all pertinent letters to FIC and AIC's auditors e.g. our May 11, 1984 contained some very serious concerns which Bruce Pennock stated he never received a copy.

Those recommendations were forwarded to Eldridge, his superior.

On July 9, 1984, Saleh, who had indicated both to me in my interview with him and in his testimony at the Code Investigation that he did not feel himself free to act without the permission of the Deputy Minister, forwarded a memorandum setting out his concerns and requesting permission to act to the Deputy Minister, Martin. The text of that memo is as follows:

> "As you are well aware the above two investment contract companies are part of the Principal Group which includes Principal Savings & Trust Company (PSTC).
>
> All three companies are in critical situation because of a serious mortgage arrears problem and the decline in the underlying value of real estate held as security for loans.
>
> Because the trust company is insured by the CDIC, it attempted to satisfy the corporation's requirements by transferring its interest in the large joint mortgages and real estate holdings to the two contract companies for the book value of approximately $23 million paid out by FIC and AIC.
>
> CDIC, however, remains unsatisfied unless they receive my assurance that such a transaction is acceptable to me. Because the transaction adds real estate and mortgages in arrears to the portfolio of FIC and AIC while taking $23 million in cash out of the two contract companies to the detriment of their contract holders, I have so far insisted that the transaction be reversed.
>
> Meantime, Jim Darwish has directed our staff auditors to obtain appraisals of mortgages and real estate held by the two contract companies. The appraisers appointed by our auditors performed their appraisal in accordance with the instructions

given to them under Mr. Darwish's direction. Fourteen mortgage and real estate parcels were appraised and the reports submitted to me indicate over 60% write down in the book value of the properties appraised. Because of the current absence of a market for real estate in Alberta, these appraisals appear to express "opinions" rather than the true market values. Mr. Darwish, however, persisted in his request for more appraisals. You declined his request since more appraisals would cause a drain on our budget for no apparent useful or meaningful purpose.

Based on the appraisals obtained Mr. Darwish's advice to me is that the two contract companies need capital injection of $50 million for FIC and $20 million for AIC.

As you have seen at our meeting with Mr. Ken Marlin, President of the two contract companies and his officials, they all vehemently reject Jim Darwish's assessment. Touche Ross and Co., the external auditors for the two contract companies, are also in disagreement with Jim Darwish's position. Our auditors indicate to me that they are having difficulty getting information from the two companies. It seems to me that there could be some kind of personality conflict in this regard.

Under the ICA, I am required to make a decision as to the amount of capital and reserves required to provide for losses on mortgages and real estate held by FIC and AIC. That decision must be made on proper and practical evaluation of the two companies' mortgage and real estate assets and at the same time take into account the protection of the interests of the companies' contract holders.

> Because of the current economic downturn and depressed real estate market experienced by our province and because of the importance of the decision that has to be made, I would request the Minister's permission and yours to solicit outside professional advice from a firm of chartered accountants of the Minister's choice, for an overall assessment of the financial position of FIC and AIC based on proper valuation of their assets and practices and at the companies' expense.
>
> Section 32 of the ICA empowers the Superintendent to authorize any person to conduct an examination and inspection of the companies' affairs and to charge any fees he considers proper for such inspection.

Saleh said he met with Osterman and Martin as a result of this memo. They advised they were not prepared to engage an independent consultant because it might cause a run on the companies. There was optimism that real estate values would recover.

On July 9, 1984, Hutchison forwarded a report to Eldridge setting out the effect of the non-accrual of additional credits by FIC. FIC was accruing and not paying interest on $94 million worth or 37% of all of their investment certificates. By doing this, they had reduced their interest expense by almost $2.5 million during the four month period ending April 30, 1984. He attached Minutes of a meeting of the Directors of FIC which confirmed that credits would not be accrued on the series of certificates maturing after April 1, 1985.

On July 16, 1984, Marlin wrote to Saleh giving what he called a "progress report". In that report, he disclosed the existence of what has become known in the Code Investigation as Transaction #3. On June 29, 1984, this complicated transaction took place:

(1) AHL purchased from Allarco Group Ltd ("AGL"). all the shares of Allarco Energy ($17,250,000), all the shares of North West International Bank & Trust Company ($19,800,000) and 50% of Travellers Acceptance Corporation Ltd. ($1,000,000). AHL paid for these assets by issuing 36,340,000 preferred shares at $1.00 each ($36,340,000), and 68,400 PGL 6% second preferred shares at $25 each ($1,710,000), totalling $38,050,000.

(2) FIC and AIC purchased 36,340,000 shares from AGL for $1.00 each ($36,340,000) and paid for them by

(a) transferring the Ventures Properties ($7,800,000) to 314986 Alberta Ltd, which was a wholly owned subsidiary of AGL (314986 was incorporated on June 5/84)

(b) transferring to AGL Carma debentures ($2,700,000)

(c) transferring to AGL Nu West debentures ($4,800,000)

(d) crediting to the purchase price to be paid by 314986 under agreements for sale ($5,840,000)

(e) paying cash to AGL ($15,200,000)

PGL then redeemed its second preferred shares from AGL ($1,710,000) and paid with Carma debentures ($975,000) and Nu West debentures ($735,000).

FIC and AIC then sold 7 owned properties to 314986 for $21,040,000, (book value $22,360,000) under agreement for purchase and sale. After credit to purchase of ($5,840,000), the sum of ($15,200,000) was outstanding on the agreements.

FIC and AIC then loaned 314986 for the sum of ($2,000,000). ($1,500,000) was advanced to 314986 and ($500,000) paid to PGL on behalf of 314986 in a Sinking Fund. PGL issued a promissory note to 314986 ($500,000). The note was pledged to FIC and AIC as loan security, with a mortgage on the Venture Properties.

There were other terms in the transaction but in summary AIC and FIC disposed of assets in excess of market or approved value and in return acquired AHL shares. This transaction was prejudicial to the contract holders and was in part consummated to improve PGL's consolidated financial statement.

Because the real estate and bonds were transferred out of FIC and AIC at book value, write downs on their value were avoided and the financial statements of the companies substantially rehabilitated.

Marlin further wrote to Saleh on July 18, 1984, stating flatly that the reason for transaction #3 was to dispose of $38 million worth of property to the Allarco Group in exchange for better assets.

On July 20, 1984, Marlin wrote to Saleh and stated that because of the recent improvements in the affairs of FIC and AIC, additional credits would be declared and paid after all.

On July 23, 1984, Saleh wrote to Darwish stating

> "I am concerned that the basis we used to determine the value of the mortgages in arrears and foreclosed real estate may now appear to be unreasonable and unrealistic in view of the circumstances. If we pursue the company on such basis, we may

> expose the department to civil liability and the possibility of being accused of acting irresponsibly".

He, therefore, asked that the valuation methods used by Touche Ross and Co. and CDIC for their valuation of the mortgage assets and real property owned by FIC and AIC and PS&T be examined by the audit staff. Darwish felt this would be of no value whatever, and replied to Saleh, in part:

> "At one of the meetings, the companies' external auditor was in attendance and he did go over, in a brief way, their method of valuing mortgages in arrears and real estate. We were not particularly impressed with the method used. For example, some values were based on an A. E. LePage representative making enquiries and doing some comparisons of properties and then reporting back to the audit firm on a verbal basis only.
>
> You asked the auditors to examine the "bases" used by the C.D.I.C. in arriving at their values for mortgages and real estate and to provide you with their comments. Prior to the original preparation of your letter of May 11, 1984, you were presented with information by way of a memorandum dated May 7, 1984, and additional discussions pointing out the basis for the C.D.I.C. valuation and that they were higher than ours. You agreed at that time to use our valuations because they were based on independent appraisals commissioned by our department and other reasons. Thus you have already been advised of the basis of the C.D.I.C. calculation.
>
> In addition, your letter outlined the method that was used in arriving at our valuation and it advised the company

> that if they disagreed with our assessment, we were prepared to revise it provided they could supply us with appraisals done on a mutually acceptable sample basis.
>
> As stated above, in 2 1/2 months, they have provided us with nothing but lengthy verbal explanations and a couple of paragraphs in their letter of June 19, 1984, none of which are supported by appraisals or other documentation to show that our figures require amending."

Darwish suggested that the only reliable way to value property was to obtain further appraisals.

On August 13, 1984, Hutchison reported on his annual examination of the financial statements of FIC and AIC for the year ending December 31, 1983. Contrary to what had been promised by Marlin in earlier meetings, the results showed a very substantial deterioration. Hutchison commented regarding FIC, that under the section 8 tests, the deficit in unimpaired capital was $62.5 million at December 31, 1983, and $80.1 million at April 30, 1984. The deficiency in qualified assets was $107.2 million on December 31, 1983, and $130.5 million on April 30, 1984. The deficiency in certificate reserves was $59.8 million on December 31, 1983, and $75.8 million on April 30, 1984.

The borrowing to capital ratio on December 31, 1983, was 250:1. On April 30, 1984, it had deteriorated to 376:1. For the first time, a breakup value calculation assuming an insolvency was determined. The breakup value calculation at December 31, 1983, was a deficit of $55.1 million. As of April 30, 1984, it was $73.5 million. 77% of the FIC mortgages were in arrears. FIC had done nothing to correct the deficiencies pointed out in Saleh's May 11, 1984 letter. Additional information had been requested from them and was not forthcoming. He concluded that FIC was virtually insolvent, and was depending on new customers to pay off the old. He indicated the company was reluctant to put up additional capital, did not follow the directions from the Superintendent of Insurance, and participated in non-arm's length prejudicial transactions. He stated the company would require a 25% return on its producing assets in order to break even. He noted that as of April 30, 1984, it had capitalized $22.5 million in interest arrears. He pointed out that cooperation from the company management was poor, and the audited financial statements had been filed late.

The figures for AIC were equally as bad. The shortage in unimpaired capital was identified as being $24,800,000 as at December 31, 1983, and $24,097,000 as at April 30, 1984. Qualified assets on deposit were deficient in the amount of $33,674,000 on December 31, 1983, and $33,034,000 on April 30, 1984. Reserves were deficient in the amount of $21,308,000 as at December 31, 1983, and $21,397,000 as at April 30, 1984. The borrowing to capital ratio at December 31, 1983, was 94:1, and as at April 30, 1984, was 115:1. The breakup value calculation as at December 31, 1983, was a deficit of $19,967,000. As of April 30, 1984, that deficit had increased to $21,406,000. 70% of AIC's mortgages were in arrears and not producing.

Eldridge forwarded Hutchison's reviews to Saleh with the comment that both companies have a "serious capital deficiency and remedial action must be taken immediately. (The companies') financial situation is comparable to that of the credit union movement."

On August 20, 1984, Hutchison wrote to Eldridge about the review of the audited financial statements of December 31, 1983, and the unaudited interim financial statements of June 30, 1984, of

PS&T. He pointed out certain shortfalls, and stated that although the Director had written to PS&T on May 30, 1984, these had not yet been remedied, but did find that the company had sufficient capital.

Beginning in August 1984, officials of CCA, including B. A. Rodrigues, the Deputy Superintendent of Insurance, Zaf Bokhari, accountant, and Eldridge, together with Saleh, reviewed an application form and contract submitted for approval by FIC and AIC. It may be recalled that the word "guaranteed" on these forms had always been the subject of some discussion between the department and the companies, as a part of the department's approval of contracts, circulars, application forms, pamphlets, and brochures, under sections 24 and 25 of the ICA. These brochures featured words like "Feature Safety Benefit - Your money is fully guaranteed" or "Feature: Safety. Your deposits are fully guaranteed." It should also be recalled that in October of 1980, officials of CCA questioned the statement "Assets equal to 100% of the certificate liabilities are maintained on deposit with a government approved custodian". See **Exhibit 7**. Because some of the assets were maintained in a U.S. depository, it was felt they did not comply with the ICA. After a full and complete examination of the application form, by all of the officials involved, FIC was advised on September 28, 1984,

> "On the back side of the application form, it is stated the company has on deposit, assets equal to 100% of its liabilities with a Canadian Chartered Bank. Under the present financial circumstances, we do not agree with this statement. However, if you wish, a statement similar to the following may be included: 'Company is required under the Investment Contracts Act to maintain funds with a Canadian Chartered Bank equal to its liabilities to the holders of its contracts.'" See **Exhibit 8**.

Saleh testified that he thought that the change in wording from 'has on deposit' to 'required to maintain on deposit' was a "flag to the public" that there was something they should look behind in the wording in the application form. He believed it should alert them to raise inquiries.

On August 31, 1984, Eldridge reported to Saleh that he was having difficulty getting information and even receiving return telephone calls from Petracca. He states, "This year is the first time we have experienced a lack of cooperation from PGL."

Throughout the fall of 1984, officials of CCA consistently sought further information about transaction #3. By this time, Saleh had formed the opinion that the AHL preferred shares, which were the main asset received by FIC and AIC as a result of this complicated transaction, were not qualified assets. They continued to be counted or treated as such by the companies in meeting the section 8 tests of the companies until they ceased operations. Without the acceptance of those shares as qualified assets, the companies' position would have been substantially worse than that reflected by the auditors.

On October 11, 1984, Hutchison completed an update on the affairs of FIC based on monthly financial statements received to July 31, 1984, on which he reported to Eldridge who in turn reported to Saleh. That review contained further alarming information. Hutchison noted that since December 31, 1984, FIC had increased its borrowings from the public by $45 million or 18% to $293 million while its unimpaired capital decreased from $1.1 million to $514,000, according to the companies' figures, which, of course, the department would not accept in any event. As he points out, during the same period, PS&T borrowings, which would have had to have been supported by additional capital, increased only $2.4 million or 2%.

Hutchison indicated Marlin had told him in a meeting held with him on October 2, 1984, that FIC required additional funds in order to help carry their non-producing assets. Hutchison said it was his belief that FIC was dependent on additional money from the public to help cover its present operating costs caused by a significant amount of non-income or low-income producing assets.

The borrowing to capital ratio had deteriorated to 578:1. In order to meet a 25:1 borrowing to capital ratio, additional capital of $11.3 million was needed even if the companies' figures as to its valuation of assets were accepted. Cash and term deposits were only $4.2 million, in spite of borrowing from the public in excess of $294 million. As at March 31, 1984, FIC had $26.1 million worth of certificates due in less than three months and a $112.3 million worth of certificates due in less than one year. Although losses were only shown as one million dollars over the seven month period, January 1 to July 31, 1984, Hutchison felt that if the appropriate figures were derived, the losses would be much greater. Hutchison's recommendations were telling, and are as follows:

> 1. I recommend that we have the company again provide us with quarterly audited financial statements or at least comfort letters from Touche Ross on the monthly financial statements as the statements currently being received are of limited use in evaluating the financial condition of the company.
>
> 2. It appears from information provided by FIC that the company is declaring additional credits at the end of each quarter for the quarter. It is not clear whether the company is accruing the additional credits during the quarter and this fact should be determined from the company as this would have a material effect on the financial condition of the company.

3. It is becoming more and more evident that this company is headed for serious financial disaster and additional capital is urgently needed as pointed out in my year end audit report dated August 13, 1984 and my October 6, 1983 audit report and my update reports.

4. I recommend that we consider suspending FIC from selling additional certificates at high interest rates in order to protect future consumers. FIC by their own admission indicated that they are attracting additional capital in order to help carry their non-producing assets. I suspect if FIC were borrowing from the bank rather than the unwary consumers that they would have been placed in receivership long ago.

5. The public is intentionally being misled by FIC in regards to additional credits. FIC has changed its policy on additional credits three times in 1984 and we have no evidence of the public ever being notified of any of these changes. The three changes are as follows:

(a) Suspend additional credits on certain certificates (May 8, 1984).

(b) Reinstate additional credits on certain certificates cancelled in (a) above

(c) Changing from declaring additional credits at the beginning of the quarter for the quarter to declaring additional credits at the end of the quarter for the quarter. (June 1984)

All these changes have a material affect (sic) on the amount the consumers receive in interest on their certificates, it is crucial that they be advised of any changes, especially the above material changes.

For AIC, the figures derived were equally bad, although AIC had decreased its borrowings from the public by $2 million to $82 million. The same recommendations were made for AIC.

On October 17, 1984, Eldridge met with Pennock, the partner of Touche Ross in charge of the external audit of FIC and AIC, in order to discuss appraisals of various properties owned by those companies. The "appraisals" given by Pennock were not true appraisals, but were "a market analysis and preliminary opinion" and a "review of market levels available" respectively. Eldridge discussed that approach with appraisers he knew who told him that this was a type of appraisal that could be subject to change and the research would be limited. They were not aware of any financial institution that would accept this type of appraisal as a basis for lending, and the appraisers he contacted stated that if they issued similar documents they would include a disclaimer that this was not an appraisal. Eldridge noted there were no disclaimers on the documents reviewed with Pennock.

On October 29 and again on November 1, 1984, Eldridge reported in detail to Saleh regarding the differences in valuation method between Touche Ross and the departmental auditors, and suggested that proper appraisals were necessary to obtain a more definitive view. He also suggested that an independent accounting firm be retained to review what had been produced to date, although he was confident of the department's approach. Again, on November 5, 1984, he made it clear to Saleh that the difference in land and mortgage values as recorded by Touche Ross and by the departmental auditors was a simple difference of opinion as to whether or not the decline of real estate values in Alberta were temporary or permanent. The department thought they were permanent or long term. Touche Ross viewed them as temporary, and therefore felt entitled under the guidelines issued by the Canadian Institute of Chartered Accountants to account for these assets at book value with some small reserves against losses and to include a note or statement to the financial statements called a Loss Provision Note or Exposure Note indicating that a loss might be experienced if a recovery of real estate values did not occur. As Eldridge pointed out to Saleh, there was no real disagreement on the fact that at the current time, the real estate was not worth the book value recorded on the financial statements.

On October 24, 1984, Saleh received an opinion from S. A. Bercov, Q.C., of the law firm of Emery Jamieson, in Edmonton, Alberta, that transaction #1 was not permitted pursuant to the ICA, and indeed that entering into it may have been an offence under section 42 of that Act which Saleh might consider reporting to the Attorney General. He indicated that the Superintendent had no specific authority to require the transaction to be reversed or to make an order requiring an injection of further capital to remedy the transaction, but did indicate the Superintendent might take that position. He pointed out that the remedies of the Superintendent lay in the suspension or cancellation of the companies' registration, or in the making of a special report to the Minister pursuant to the provisions of the Act.

On October 29, 1984, Eldridge reported to Saleh that at a meeting with Marlin on October 2, 1984, in answer to his questioning Marlin as to the reason why FIC was increasing its certificate liability so drastically, Marlin stated that the increase in certificate liability "is necessary to provide increased asset earning base as the company has a significant amount of non-income producing assets". Eldridge pointed out that in order to repay these certificates, the company would have to earn, given the figures that he had concerning sales commission, return on investments, overhead, and reserves, 17% on the money invested. As he stated "I am not aware where the company could place its additional funds to earn the income needed to cover these liabilities."

On November 1, 1984, Marlin forwarded to Saleh a letter setting out an arrangement to resolve the conflict concerning the capitalization of FIC and AIC. In a memo November 2, 1984, Eldridge stated that he was unable to understand Marlin's proposal to appropriate $10 million of FIC's tax paid capital account or subordinated loans through the tax paid capital account. There was to be no immediate injection of capital but this amount was to be "accumulated through earnings utilizing tax loss carry forwards." Marlin agreed to have Virginia Nicholson, C.A., confer with Eldridge about this matter. Eldridge's comment at that point was "This proposal as presented appears to be an attempt to place the provision for loss into the equities section Balance Sheet which is not an acceptable accounting practice." Once this matter was clarified, Eldridge reported to Saleh that the proposal should be rejected, as what was being proposed was not provided for either under generally accepted accounting principles or the ICA.

On November 27, 1984, Saleh wrote a memorandum to Eldridge setting out the fact that he agreed that AHL shares were a prohibited investment under the CBICA of Canada and thus were in contravention of section 34 of the ICA.

On November 29, 1984, Saleh instructed Eldridge, through Hutchison, to contact Marlin and to take the position that transaction #3 was in contravention of the ICA.

On December 17, 1984, Hutchison documented a discussion he had with S. W. Johnson, C.A., Controller of PGL, who advised him that the financial statements for the Northwest International Bank and Trust Co. in the Cayman Islands would not be provided but could be reviewed on the company premises. Hutchison indicated to Eldridge that was totally unacceptable and to properly regulate FIC and AIC, that information was necessary.

Further on December 17, 1984, Marlin wrote to Saleh stating that Principal Group would offer to contribute additional capital to FIC by way of a subordinated amount of $11,300,000 as an overall settlement regarding all outstanding items in Saleh's letter of May 11, 1984, including both the concerns of transaction #1 and the concerns of the substantial shortfalls in the financial statements for December 31, 1983. Hutchison reviewed the proposal at the request of the Deputy Minister, and reported to Eldridge that it was unacceptable because in order to meet the requirements of the ICA, a capital injection of $21.3 million was necessary, failing which he recommend that the company not be licensed under the ICA.

On December 18, 1984, Saleh wrote to Marlin and indicated that he would accept the injection of the $11.3 million by way of a promissory note subordinated on terms acceptable to him but only as a settlement of his concerns related to transaction #1. He would not accept it as a settlement of the capital deficiency concerns, but did agree to forego other action because Marlin had assured him that the 1984 results would show improvement. Five million dollars was to be deposited in cash concurrent with the execution of the letter, on December 21, 1984, and the additional $6.3 million was to be injected no later than December 31, 1984. Those amounts were paid, the five million on December 17, 1984, and the $6.3 million on December 28, 1984. The following is an excerpt from the testimony of Hutchison at the Code Investigation. (TR. Vol. 142, Page 26499)

> Q. Did you subsequently learn something in connection with what happened to 5 million of the 11.3 million that had come in to FIC?
>
> A. Yes.
>
> Q. What did you learn?
>
> A. That 5 million had been repaid; 5 million out of the 11.3 million had been repaid.
>
> Q. Now, when you say repaid, was it the case that it was repaid back to PGL?
>
> A. I believe that is where it came from, yes.

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(4) Regulatory Events for Time Period January 1/85 to June 30/86

During this period, the deterioration in the affairs of FIC and AIC continued, and again during this period there was monitoring but no action by the officials of CCA.

On January 29, 1985, just before he left public service, Hutchison reported to Eldridge concerning a number of matters. Firstly, he reported that FIC was now declaring additional credits at the end of the quarter, which reduced their additional credit expense approximately 12% for the year and in the case of FIC amounted to an understatement of expenses or an overstatement of income of approximately $2.5 million. As well, this change was not being brought to the attention of the contract holders, for obvious reasons. He concluded:

> "The method currently used by FIC to record additional credits materially understates both liabilities and additional credit expense and I recommend that company officials be required to account for additional credits in the correct method.
>
> In addition we are receiving more and more evidence that the company officials can no longer be trusted eg. Carma sale, PS&T sale, misleading monthly financial statements, misleading mortgage reserves, misleading real estate values, stopping and reinstatement of additional credit interest, expense, etc. and it is therefore essential that we obtain quarterly audited financial statements that can be relied on."

On that date, he further reported to Eldridge about an analysis of AIC's November 30, 1984, monthly financial statements. He reported that AIC purported to show a profit of $223,000 for the month of November, when a calculation in accordance with the usual reporting requirements would have shown a loss of at least $258,000. He stated that no qualifications were put on this report even though there were two material departures from previous financial statement presentations. The effect of this was to wipe out any of the companies' unimpaired capital on its records, as its statement showed unimpaired capital of $531,000. The borrowing to capital ratio had reached 163:1. It was obvious AIC needed the improper adjustments to income in order to show an unimpaired capital of over $500,000. Hutchison concluded "As indicated in previous memos, the monthly financial statements are very misleading and are completely unacceptable to monitor the company".

Finally, on that date, he reported to Eldridge about his analysis of transaction #3. Further information about this transaction had been continually requested and slowly obtained from FIC and AIC over the prior several months. He stated in his conclusion, "In my opinion, this transaction is a complete sham as no company, especially a company (Carma) on the verge of bankruptcy with serious cash flow problems is going to pay over book value for bonds that have a market value of only 30¢ to 35¢ on the $1.00 and pay over book value for a $7.8 million mortgage that has a (sic) appraised value of the underlying property of less than one million. In addition, it appears that 314986 Alberta Ltd. does not have to put up any additional money to service the Agreement for Sale and that they are effectively acting as a property management company for FIC and AIC for FIC's and AIC's real estate."

On April 29, 1985, the Priorities, Finance and Coordination Committee struck a new Task Force to monitor the financial position of Provincial Trust Companies. This Task Force was chaired by the Provincial Treasurer, Lou Hyndman, and included Osterman (CCA); Neil Crawford (Attorney General); Allister McPherson (Deputy Minister, Treasury), and Martin (Deputy Minister, CCA).

Evidence at the Code Investigation shows information with respect to AIC and FIC did come to the attention of the Priorities Committee. The information did not indicate an urgent situation but that there were ongoing problems.

On May 22 and June 26, 1985, Bokhari and Eldridge each reported on the income and expense statement for the three months ending March 31, 1985, supplied by FIC and AIC. Bokhari, in summarizing the problem, pointed out that the statement showed a net loss of $4,861,413 for the first three months of 1985, and thought there was danger of a still larger size loss as the statements were prepared using a great deal of estimating. This fact was pointed out to the department by S. W. Johnson, the Vice President of Finance for PGL. Bokhari pointed out to Saleh that on October 24, 1984, he had telephoned Marlin who agreed to comply with the request of quarterly filing of audited statements, but none had been received. He recommended, as did Eldridge, that a demand for a quarterly financial statement be filed with mutually agreed upon due dates. As well, Eldridge recommended that the companies be requested to supply a forecast of profit and loss for the remainder of 1985 and the first half of 1986, supported by a comfort letter from its auditors as to its accuracy.

On June 14, 1985, Christine Kavich, Marketing Assistant for the Principal Group, forwarded to Bokhari a certificate brochure for FIC and AIC. That brochure contained, among other statements, the statement "Safety, Flexibility, Competitive Rates and More!"

> "You're looking for a safe investment ... Safety: Your Money Is Fully Guaranteed! First Investors and Associated Investors are investment contract companies and are regulated by the Investment Contract Act. Assets equal to 100 percent of certificate liabilities must be maintained on deposit with a government-approved custodian. Assets are invested in securities which qualify under the Canadian and British Insurance Companies Act, the same regulations that govern Canadian life insurance companies. Investment contract companies and life insurance companies do not accept demand deposits and their products, therefore, do not require the additional protection of the Canada Deposit Insurance Corporation."

> "COMPETITIVE RATES - Earn A High Rate Of Return! You receive the high rates the company is paying to its investors."

This brochure was quite similar to the existing brochures that had been approved by CCA, pursuant to the ICA, over many years. Eldridge had concerns, however, which he reported to Rodrigues on June 26, 1985. They included reference to the word "safety" and "safe". He stated "I am hesitant to approve 'safe' as an adjective referring to an investment." He insisted the sentence "Investment contract companies and life insurance companies do not accept demand deposits and their products, therefore, do not require the additional protection of the Canada Deposit Insurance Corporation" be deleted. He felt that additional credits should be referred to, otherwise the investors would be led to believe that interest rates are fixed by the companies. He quarrelled with the reference that assets were invested in securities which qualify under the CBICA. A major investment of the contract companies was in AHL preferred shares which the department did not accept as a qualified investment. In the end result, the brochure was approved by Rodrigues, with only the following changes: The caption "Safety: Your Money Is Fully Guaranteed!" was changed to "Safety: Your Money is Secure". The sentence "Investment contract companies and life insurance companies do not accept demand deposits and their products, therefore, do not require the additional protection of the Canada Deposit Insurance Corporation" was amended to read "Products offered by investment contract companies and life insurance companies are not covered by the provisions of the Canada Deposit Insurance Corporation." The remaining references to safety, and high interest rates, were not the subject of objection, even though the failure of these companies to meet the financial tests under the ICA formed a large part of the recent regulatory experience with FIC and AIC.

In June of 1985, the audit staff of CCA, both on behalf of the Director of Trust Companies monitoring PS&T, and the Superintendent of Insurance, monitoring FIC and AIC, conducted a review of a transaction called transaction #5 in the Code Investigation. This was a transaction entered into by PS&T, FIC, and AIC, with a company known as General Equities Holdings Ltd. (General Equities), which involved its wholly owned subsidiary, Shucksan Properties Inc. (Shucksan). This transaction took place in June of 1985, and was very complicated.

In the transaction, PS&T, FIC, and AIC, sold six properties and two mortgages in which they held interests to General Equities, for amounts greater than either their book value or their appraised value, and financed the purchase 100% by no recourse loans and mortgages. The term "no recourse" means that if there is failure to repay the loan or mortgage, the company loaning the money is limited only to taking back the land or other security for the loan or mortgage, and realizing on it. If there is any shortfall in the amount obtained through those actions, the borrower is not responsible for it because there is "no recourse" to the borrower for the deficiency.

A further feature of the transaction was that General Equities would retain 50% of any profits that it made on the assets transferred. The deal was further complicated by the fact that the amount loaned to General Equities' subsidiary, Shucksan, to complete the deal was invested by Shucksan in bonds which were then held in trust for Shucksan in a PS&T trust account. Auditors with the Director of Trust Companies were highly concerned about the effect of this transaction.

Firstly, the loans to General Equities were at far less than the market rate. Secondly, PS&T was able to record the receipt of the purchase price on its books, although the actual receipt of those funds was in doubt, given the nature of the purchaser, General Equities, which

(a) had no assets and in any event had no recourse under the loans, and

(b) the nature of the loans themselves, at far less than market rate, and

(c) the nature of the security for the loans, that being over-valued property.

If General Equities did do well in managing the properties, only one half the gain would be realized by PS&T although all of the risk was taken by PS&T.

It appears this transaction was entered into for the purpose of alleviating CDIC's concerns about PS&T, and its problems of matching of assets with liabilities. The only benefit to the transaction for FIC and AIC would appear to be to improve the appearance of their financial statements, as they avoided an asset write down, according to a later calculation by Clarkson Gordon for the Code Investigation. Clarkson Gordon's report indicates that in the Deloitte Haskins & Sells audit files of PGL for 1986, they concluded that no sale took place as the purchaser, General Equities, did not advance any of their own money, had no risk associated with the deal, and had no risk or benefits associated with the bonds placed with PS&T. As well, operations of the properties were subject to the control of PS&T. The external auditors had accepted this transaction at face value for the preparation of the 1985 annual statements, because they did not have enough information. They did, however, reverse the transaction for the purpose of the 1986 annual statements.

Another matter which came to be of serious consideration in 1985 was the continued registration of FIC as an approved corporation under the Trustee Act of Alberta.

By section 4(1) of that Act, the Lieutenant Governor in Council could approve a corporation as being an appropriate recipient of funds to be invested by Trustees, meaning those holding money on behalf of others with the legal responsibility to invest funds and account for them, within Alberta. Under section 4(3) the ASC was to be provided with financial information to support continued approval as an investment vehicle, in the form of a quarterly or monthly balance sheet or operating statement, a certified copy of an annual balance sheet together with an auditors' report verifying it, and any other financial information the ASC might require. One of the requirements of the Trustee Act was that those statements were to evidence $1 million in unimpaired capital, meaning capital free of any other obligation. It was clear to the ASC in the spring of 1985 that FIC was deficient in capital, and therefore could not meet that requirement.

A history of FIC's involvement with the ASC regarding its approval under the Trustee Act is questionable. From ASC records, FIC failed to satisfy the capital requirements in 1965-1966, 1971-1975, and 1984-1985. The ASC, in reviewing the matter in 1985, found it had no record of financial statements of FIC for the years 1976-1980, and was forced to request replacement statements from CCA.

Lemay, who was then the Deputy Director - Filings at the ASC, wrote to Marlin on September 21, 1974, pointing out the deficiencies, and met with him concerning that matter on September 20th and October 18, 1974. Marlin disputed the calculations of capital reserve by the ASC, and the fact there was a deficiency (which was the usual practice of any of the companies within the Principal Group when challenged). He was successful in convincing Lemay not to cause a report to be made to the Lieutenant Governor in Council withdrawing the approval of FIC under the Trustee Act, in exchange for an agreement that FIC would not accept trust funds. This was done on the basis that the adverse publicity of withdrawing the approval would have harmful effects on the business of FIC. That written undertaking was given by letters dated October 21, 1974, and February 11, 1975. From that time until July of 1985, no report on the affairs of FIC regarding its Trustee Act status was ever made by the ASC.

In my interview with her, Ms. M. Childs, Deputy Director of Franchises, stated that no policy of follow up of information filed with the ASC by companies having Trustee Act approval was in place at the ASC until 1984, when her immediate superior, Marc Lemay, the Director, gave her that responsibility. It is obvious that until that time there was no effective regulation of approved companies under the Trustee Act by the ASC. Further, in 1974, it was clear that FIC could not meet the minimum capital requirements. Darwish was also concerned about this designation and had raised it in his memo of concern of April 24, 1984, intended for the Minister.

Once the problem with FIC's Trustee Act status was brought to the attention of Childs, she immediately alerted Saleh, who in turn advised her that the status of FIC as an approved corporation under the Trustee Act had never been considered by his office. She then contacted Johnson, PGL, on July 3, 1985, who agreed it would be difficult to determine whether funds invested with FIC were trust funds or not, and agreed to attempt to find a solution to the problem. On the following day, a letter was delivered to Childs by Marlin stating that FIC's policy was not to solicit trust funds, but it was up to the investor to reveal whether they were investing trust funds or not. If trust funds were the subject of the investment, he advised FIC's policy was to refer the trustee to PS&T. In regard to his letter undertakings of 1974-1975, he stated, "FIC considers the 1975 letter to be for the period then current and not as an on-going undertaking. The nature of the undertaking then given was a reconfirmation. Presumably it is a matter of annual review."

John Van Riper, a Commission Solicitor, wrote to FIC on July 5, 1985, suggesting FIC request revocation of its Trustee Act approval. Failing this, ASC staff would seek the approval of the ASC to advise the Lieutenant Governor in Council that FIC no longer qualified. On July 8, 1985, FIC delivered such a request to the Lieutenant Governor in Council. It was not acted upon because the Cabinet, at that time, was reluctant to make any change to the status of FIC given the concern, more clearly outlined elsewhere in this report, that any information that became public concerning the financial situation of the investment contract companies would be harmful. ASC staff were advised by Lemay that he had been advised by the Deputy Minister that the Lieutenant Governor in Council was aware of the financial standing of the company, and would take no further action to deal with its Trustee Act status. No further action was taken by ASC concerning FIC's Trustee Act status. The request by FIC to revoke its Trustee Act status was never dealt with prior to the company ceasing operations. The expressed reason was that Cabinet was awaiting a report by CCA; the real reason was clearly the fear of an adverse reaction on the affairs of the company.

A second issue involving FIC and the ASC arose in 1985. This issue arose as a result of the examination of FIC's application to market a preferred share offering.

FIC, in early 1985, made application and filed a draft Preliminary Prospectus to allow it to market to the public a $50 million issue of its preferred shares. At the same time an application was presented to allow PCL to sell those shares under exemption from the usual requirement that such shares would only be marketed by a registered securities dealer. These applications involved consideration by ASC staff, including Childs and R. Sczinski, C.A., Deputy Director, Securities, and their support staff. In an attempt to assess the accuracy of the Prospectus information provided by FIC, and compliance with the Securities Act by both the FIC application and the PCL application, an extensive review of the financial statements of FIC, PCL and PGL was conducted by ASC staff. Meetings were held with Saleh, Eldridge, and other staff members of CCA. The Commission was provided up-to-date financial information about the status of FIC and PGL, by the audit personnel of CCA. CCA personnel insisted that proper channels be followed in sharing the information and it was provided. As part of the process, Childs and Sczinski on April 3, 1985, made a formal request of Saleh, as follows:

> "Further to our meeting April 2, 1985, at which Ms. Childs, Mr. Coen, Mr. Rodrigues and Mr. Saleh were present, we hereby request your written approval of the proposed preferred share offering of FIC and the sale of this offering by PGL salesmen. From our brief discussion, you expressed concerns pursuant to your responsibilities under both the Trust Companies Act and the Investment Contracts Act."

This request obviously highly concerned Saleh. In a memo from Mark Brown, C.A., Senior Financial Officer of the ASC to Sczinski and Childs, he stated:

> "Mr. T. Saleh ... is seeking legal advice in respect to his involvement with the 116 application and other concerns discussed at your meeting with him on April 12, 1985."

Saleh did seek legal advice, and caused his solicitor, Bercov, to meet with the solicitor for the ASC, Michael F. Hayduk, on April 30, 1985. Bercov sought confirmation that the ASC staff did not expect Saleh to approve the Prospectus, but that the request to him was only a request for advice as to whether the Prospectus raised any concerns with respect to Saleh's administration of other legislation affecting FIC. In the end result, both applications were not proceeded with by the applicant, in the face of the expressed concerns of the ASC about

(1) the ability of FIC to pay the dividends to be attached to the preferred shares,

(2) the adequacy of the disclosure of relevant financial information in the draft Prospectus, and

(3) questions about the ability of PCL sales people to offer independent financial advice about an issuance of shares by a related company.

As a result of FIC's application, concerns were raised by the ASC about FIC's continuance as a registered mutual fund dealer. It was clear by early 1985 that FIC could no longer meet the minimum net free capital requirements, and indeed was in a deficit capital position. The ASC was aware that FIC did not function by marketing mutual funds to the public. It only acted as a distributor of mutual funds actually marketed by PCL, mainly as a method of obtaining revenue for FIC within the Principal Group. The ASC insisted that registration be withdrawn. After a series of meetings with company officials, and some perceived reluctance in management of FIC and the Principal Group in general to deal with the issue, the ASC staff issued a Notice of Hearing, to require the ASC to remove the registration. That resulted, on July 4, 1985, in an Order being made by the ASC, with the consent of FIC, allowing it to distribute mutual fund securities of issuers within the Principal Group, as an exemption from the usual requirements of the Securities Act, provided it did not deal directly with the public or handle funds, and provided it surrendered its registration as a mutual fund dealer. Again, this action of the ASC involved a full consideration of the financial affairs of FIC, with the assistance of the staff at CCA. On July 8, 1985, Marlin formally wrote to the ASC surrendering the registration of FIC as a mutual fund dealer, a copy of which letter was forwarded to CCA.

On July 18, 1985, Saleh sent a report to Martin indicating that the situation with FIC and AIC "appears to be alarming and requires reporting to you and to the Minister." He indicated "I have not yet sent any formal demands to the companies pending direction from you and the Minister in this regard."

On July 26, 1985, after some discussion with representatives of the Principal Group regarding a new brochure for FIC and AIC, a brochure in the form previously approved was again approved, with the change that the word "security" was substituted for the word "safety" throughout. The brochure therefore now read "Security, Flexibility, Competitive Rates and More! SECURITY: You Can Feel Secure!" Eldridge's comments were sought as they had been regarding earlier amendments. He again made the request that "Before approving this brochure I recommend the matters presently under discussion with the companies be resolved."

On August 2, 1985, Saleh wrote to Marlin regarding FIC and AIC indicating that he still felt that the investment in the shares of AHL was not a qualified investment under the ICA. He also pointed out that he had made capital deficiency calculations of $1,668,536 for AIC and $9,476,068 for FIC, without taking into consideration any write-down in the values of real estate assets. He requested immediate attention to forwarding the business projections earlier requested and an outline of the steps intended to rectify the capital deficiency of FIC and AIC.

On August 8, 1985, Johnson, PGL, met with Eldridge to review the section 8 tests. Johnson advised that Donald Cormie, owner of PGL, had reviewed the Act and disagreed with the method of calculation of the three tests under section 8. Eldridge pointed out those tests had been consistently calculated since he joined the department in 1976. Johnson suggested that the original tests were foisted upon the companies by the former Superintendent of Insurance. Eldridge, after the meeting, recommended rejection of the new interpretation of the tests to Saleh. Johnson also stated, alarmingly, in that meeting that there were no resources within PGL to provide any further funding for FIC and AIC. A lengthy series of meetings and discussions then ensued in CCA, which also involved the department obtaining independent legal advice from Bercov. In the end result, it was concluded that the section 8 tests might well be directed by a court to be calculated in the new and innovative way suggested by FIC and AIC given the ambiguity of the sections of the ICA involved.

On September 5, 1985, in a meeting with Eldridge, Johnson, PGL, indicated he was having difficulty with real estate transactions proposed to him by his superiors, that he thought were of little or no benefit to the companies. He wanted the assistance of the department to resist such transactions.

On September 6, 1985, the report of the audit section on the annual examination of AIC was forwarded to Saleh by Eldridge. Under the section 8 tests, the deficit in unimpaired capital had increased from a deficiency of $237,000 as at December 31, 1983, to $2.7 million as at December 31, 1984. The deficiency in qualified assets on deposit was in the amount of $2 million, compared to an excess in qualified assets of $762,000 on December 31, 1983. The deficiency in reserves was $2.2 million as at December 31, 1984, as compared to an excess of $263,000 at December 31, 1983. Because of the negative capital at December 31, 1984, which continued through June 30, 1985, the borrowing to capital ratio was meaningless. It was noted that the fourth quarter additional credits were declared in January of 1985, so that they were not reflected in expenses in 1984, which would have made a substantial difference to the statements.

It was noted as well that there were serious concerns about FIC and AIC using the PGL annual report as promotional material for prospective customers of investment contracts as this annual report had never been presented to CCA for approval as promotional material.

In his memorandum forwarding the report to Saleh, Eldridge pointed out that these deficiencies had arisen even though the real estate and mortgage balance figures presented by the company and its auditors had been used to calculate them. In the past, those figures had been written down as a result of the sample appraisals which had been done in 1984 on some of the properties of FIC and AIC, from which an extrapolation of reduced value was made. As

Eldridge commented,

> "While we believe these figures to be highly optimistic, we cannot, without having appraisals done, comment further on their evaluation."

On October 2, 1985, Saleh sought Eldridge's "thoughts" about the current situation of FIC and AIC, and Eldridge provided him a memorandum on October 22, 1985. The concerns that he had been expressing all along were again expressed. The present status of the matter within the department was clearly revealed in that memorandum, by the notation "present status - Superintendent has agreed to await FIC's and AIC's accounts and lawyer's opinion." This is regarding the controversy about the calculation of the section 8 tests.

During November of 1985, there was discussion between CDIC and Martin concerning the possibility of a joint investigation of the three regulated companies within the Principal Group, PS&T, FIC, and AIC. CDIC of course was in effect the regulator of PS&T because it imposed higher standards than the Director of Trust Companies of Alberta, in order to maintain PS&T's policy of deposit insurance. Without the deposit insurance, PS&T could not continue to operate as a trust company within the Province of Alberta, because of the provisions of the Trust Companies Act.

On November 19, 1985, Martin wrote to R. A. McKinlay of CDIC and pointed out that because there was current discussion with the officials of FIC and AIC about the interpretation of the section 8 tests, it was premature to embark on a joint examination.

This issue of the challenge to the traditional calculation of the section 8 tests by FIC and AIC became the focus of the

Superintendent of Insurance in late 1985 and well into 1986, and seemed to preclude any other action against the companies. The controversy was fairly simple. The section 8 tests involved three separate calculations;

(a) calculation of the amount of unimpaired capital of the company (to yield the minimum of $500,000 required under section 8(b))

(b) calculation of qualified assets on deposit as equal to the cash surrender value of the company's liabilities to investment contract holders, under section 8(c), and

(c) calculation of the reserves of the company (defined in section 30 to mean sufficient assets that, together with future payments on instalment contracts and interest on those assets at an annual rate subject to approval by the Superintendent of Insurance, would yield an amount at least equal to the maturity value of the investment contracts when due or payable) under section 8(d).

In accordance with sections 26 and 27 of the ICA, the companies were required to file quarterly or monthly statements, disclosing reserves and assets, and an annual balance sheet, in a form prescribed by the Superintendent of Insurance, together with a yearly audited financial statement. The practice of the departmental auditors in examining the company, from the time regulation began under the ICA, had been to value the assets of the company for all tests and statements using the limitations set out in section 29 of the ICA, which included the right to devalue stocks and bonds to market, and to reject some assets as not meeting the appropriate criteria under the ICA.

There was also the right, although it was not used, for the Superintendent to reduce the value of real estate and mortgages on real estate after the Superintendent had obtained an appraisal, to an amount not to exceed that appraisal value. The companies now argued that the tests were completely separate, and different criteria could be used to obtain the values. They argued that the different wording of the sections 8(b), (c), and (d) meant that only in calculating the net depository requirements under section 8(c) were the limitations in section 29 to be used. They produced several legal opinions to support their position, that the valuation of assets to meet the unimpaired capital test under section 8(b) and the reserve test under section 8(d) could be made. These would not be from the statements to be filed in accordance with the criteria in sections 26 and 27 of the Act, but from the audited financial statements which did not meet these criteria, including the section 29 limitations, but were calculated by the external auditors in accordance with the generally accepted accounting procedures.

The differences were significant; for example, using the December 31, 1984 figures for FIC and AIC, the departmental auditors derived a capital deficiency of $6,585,994 for FIC and $1,784,056 for AIC. The companies derived an excess of unimpaired capital for FIC of $21,830,693 and for AIC of $1,755,566. Using the new calculations, the companies were not in default of either the unimpaired capital or reserve tests. Major adjustments now rejected were the deductions made by the departmental auditors for a general mortgage and owned property reserve, and a deduction of unqualified assets that did not meet the criteria in the ICA, which in turn adopted the criteria for qualification of assets in the CBICA. For FIC, the general mortgage and owned property reserve was $10,190,000.

While the company's external auditors recognized in the audited financial statements that such an amount was appropriate to reduce the value of property and mortgage values, as at December 31, 1984, they dealt with that matter in an explanatory note to the financial statements, rather than deducting it from the value of assets on the balance sheet. The external auditors took the position that such a practice was appropriate and in accordance with generally accepted accounting principles as they were of the view that the decline in value was temporary rather than permanent. This was of course the issue of valuation under discussion between the companies and the departmental auditors throughout 1985. There was no question that everyone accepted the fact that the real estate and mortgage security held by FIC and AIC, if liquidated, would be worth only a portion of the value shown on the financial statements of those companies. The issue was one of technical compliance with the Act rather than any disagreement about real values. This issue could only have been determined by the Superintendent proceeding under section 29(3) of the ICA to force values to be related to appraisals. If that had been done, clearly those appraised values would have had to be used for the section 8 tests no matter what accounting treatment was selected.

In the meantime, other issues began to arise. On November 18, 1985 Romalo reported to Eldridge with respect to the investment by FIC and AIC in AHL shares. The companies had a legal opinion which stated that AHL shares were qualified assets under the ICA. The regulators' opinion was that the AHL shares were prohibited by section 33 of the CBICA because of the indirect controlling interest of Donald Cormie in both AHL and FIC and AIC. The regulators noted that even if they were qualified assets, there was a valuation question because there was no market value for the shares. There was also a question in the regulators' mind as to AHL's investment in 12.5 million preferred shares of PGL. This was due to PGL's substantial investment by way of shares and notes receivable in FIC and AIC, both of which were in serious financial condition. AHL owed $14.6 million to CSL, and this liability ranked ahead of FIC and AIC as AHL preferred shareholders.

On November 19, 1985 Romalo wrote to Eldridge and reviewed FIC's financial statements for the nine months ending September 30, 1985. The average loss for the company was about $1.2 million per month. On December 12, 1985, he identified AIC's losses at $340,000 per month.

On November 21, 1985, E. T. Jewitt, Deputy Superintendent of Brokers for British Columbia, wrote to Saleh about increasing concern as to the viability of FIC and AIC. Although prohibition of the sale of investment contracts in British Columbia would in all probability cause the demise of the companies, action was necessary as people were investing in the companies.

On December 4, 1985 Rodrigues replied to Jewitt outlining the differences in opinion on the section 8 tests and indicating that a legal opinion was awaited.

On December 5, 1985 the Superintendent of Insurance requested an opinion with respect to the section 8 tests from Bercov.

On January 14, 1986, a meeting was held in the Superintendent's office, to deal with the section 8 tests issue. Present were Saleh, Eldridge, Romalo, Rodrigues, Bercov, and Maurice Dumont of the law firm of Emery Jamieson. The following issues were discussed:

a) Bercov agreed with FIC and AIC that section 29 of the ICA did not necessarily apply in making the unimpaired capital and reserves calculations in section 8. However, section 29(3) allowing appraisal and revaluation could be invoked by the Superintendent even though FIC and AIC used generally accepted accounting principles instead of the section 29 calculations.

b) The generally accepted accounting principles principles used by FIC and AIC to claim decreased land values as temporary should relate to a situation of one year or less.

c) He had not reached a firm conclusion as to whether or not the AHL preferred shares were a prohibited investment for FIC and AIC.

d) He believed that subordinated notes could be considered as capital if the Superintendent agreed.

The following actions were agreed upon:

a) Bercov was to arrange a meeting between himself, FIC and AIC's auditors and lawyers and an auditing expert retained by the Superintendent.

b) Eldridge and Saleh were to obtain the services of a chartered accountant to be retained as their auditing expert.

On January 14, 1986, Johnson wrote Eldridge with respect to valuation of the AHL shares. The value was derived from valuation of AHL's assets as there was no market for the shares, it being a private company. It must be noted AIC held AHL preferred shares supposedly valued at $8.5 million, and FIC held AHL preferred shares supposedly valued at $39.9 million. The departmental auditors were concerned that the value of AHL included its ownership of PGL preferred shares in the amount of $12.5 million and its loan to CSI of $14.6 million, which ranked ahead of the preferred share issue to FIC and AIC. The $12.5 million share purchase was described as transaction #2 at the Code Investigation. They were further concerned that a large portion of PGL's assets supporting its shares, which shares were one of AHL's major assets, were PGL's ownership of FIC and AIC which companies were not viable and in effect stood as security for their own investments.

On February 17, 1986 Eldridge wrote Saleh with respect to PGL companies' stock transactions. Those transactions covered FIC and AIC and involved shares in PGL related companies. Eldridge stated he was disappointed PGL officials did not inform him of the transactions which came to his attention through a review of the ASC weekly summary. The shares involved were Matrix Investments Ltd. shares, Principal Neo-Tech Inc. shares, PGL preferred shares, and AHL shares. Principal Neo-Tech Inc. and Matrix Investments Ltd. were public companies that did trade on various stock exchanges in Canada, and were controlled within the Principal Group. Eldridge talked to Johnson and he advised the transactions had been made to reduce the non-parent related inter-company dealings within Principal Group. The net effect to FIC and AIC was to reduce their holdings of AHL shares and replace them with Matrix and Neo-Tech shares. Johnson thought FIC and AIC were better off than before, and the regulators shared this opinion because, at least some market value could be determined for those assets.

On April 2, 1986 Romalo reported to Eldridge with respect to AIC's internal monthly financial statements at December 31, 1985. The audited yearly financial statements had not yet been received. The net loss to the company for 1985 was $2.1 million. Had AIC not reversed the inter-company levy to PGL, the net loss, for the year, would have been approximately $1 million greater.

On May 1, 1986 Saleh wrote to Marlin with respect to their applications for renewal of registration. Saleh noted that on March 31, 1986 Marlin advised him the companies were not in a position to file their audited financial statements that day as required by the ICA. Johnson of PGL had advised the statements would be filed by April 25, 1986. The two contract companies remained in contravention of provisions of the Act, and in these circumstances, the registration could not be renewed. Saleh further stated he was holding the applications for renewal until May 16, 1986, and if the companies failed to file that date, he would have no alternative but to proceed in accordance with the provisions of the ICA. Saleh was questioned by Wittmann at the Code Investigation (TR. Vol. 158, Page 29361) on the filing of the statements. Saleh stated that in discussion with the Deputy Minister it was decided to give the company time. The companies met the extended deadline (TR. Vol. 158, Page 29363), and the audited financial statements were delivered on May 16, 1986. The licences were then delivered to the investment contract companies.

On May 30, 1986 Eldridge wrote Saleh and stated they had received the audited financial statements, statement of assets, certificate liabilities and reserves, at December 31, 1985 for FIC and AIC. He outlined the manner in which the section 8 tests would be done, in accordance with the opinions of Bercov's and FIC and AIC's solicitors, and asked for Saleh's concurrence.

On May 30, 1986 Eldridge further advised Saleh with respect to the statements. The auditors' opinion on the statements of assets was unqualified in concluding that particular statement complied with the reporting provisions of the ICA. The audited financial statements were qualified as to the value of real estate owned and the properties securing mortgages. The fact that an audited financial statement is qualified is very serious. It means that the auditors are unable to express an unequivocal opinion as to the reliability of those statements. Eldridge discussed this with Johnson, PGL. He stated the external auditors' qualification related to the fact that FIC and AIC thought that the values attributed to the owned real estate and the property securing mortgages could be attained over a seven year holding period. The departmental auditors felt that seven years to resolve a "temporary decline" was not in accordance with generally accepted accounting principles. The seven year period adopted by FIC and AIC appeared to be derived from section 36(2) of the ICA which allowed this period to hold foreclosed real estate as a qualified asset. This section does not refer to the value at which the real estate must be recorded. Eldridge was concerned that a precedent might be set by accepting the statement of assets filed in this manner. He requested they refer the statement of assets to legal counsel to determine if it complied with the ICA. He was not prepared to accept qualified financial statements.

On June 11, 1986, by way of Order in Council, administration of the ICA was transferred from CCA to Alberta Treasury. The Superintendent of Insurance continued as the person designated as having regulatory authority. Treasury was responsible for the day-to-day operations. This changed on January 7, 1987, when Al Kalke, Assistant Deputy Treasurer, was appointed Acting Superintendent of Insurance pursuant to the Act.

It should be noted that when jurisdiction was transferred, three auditors were also transferred from CCA to Treasury.

Saleh, in his evidence at the Code Investigation (TR. Vol. 158, Page 29367), stated they did not proceed to get another legal opinion on the section 8 test as they did not need one. They had a very serious situation, more so than in November of 1985. Although Treasury officials were taking over the administration of the ICA, he was reporting to his Minister in CCA who was discussing the issue with Treasury officials.

On June 18, 1986 Eldridge wrote Saleh on FIC noting a loss of $8.9 million for the first five months of 1986, and comparing the company's situation to the Alberta Credit Union movement and two failed trust companies.

On June 23, 1986 a copy of a letter from E. F. Smith, C.A., Acting Deputy Superintendent of Brokers for the Province of British Columbia, to Marlin was received. The companies were not complying by filing the required audited financial statements. Registrations for FIC and AIC were not renewed on April 1, 1986. The circumstances were such that the B.C. regulators requested they discontinue selling investment contracts voluntarily until the problems were resolved.

On June 26, 1986 Eldridge met with Johnson, PGL, and advised him of his status and that of the Superintendent of Insurance, due to the change of responsibility for the ICA from CCA to Alberta Treasury. In their discussions, Johnson was candid in his comments about FIC and AIC and agreed something had to be done to stop the losses. Johnson stated the reason AIC broke even at the end of May of 1986, was that some Matrix shares had been sold back to AHL at a profit. Johnson stated he thought Matrix was selling on the market for more than it was worth.

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(5) Regulatory Events for Time Period July 1/86 to June 30/87

On July 17, 1986 Eldridge forwarded an Interim Report on the examination of the 1985 financial statement of FIC. FIC's capital impairment at December 31, 1985 was in excess of $5 million, calculated according to generally accepted accounting principles as requested by FIC. The dDepartment's calculation of capital impairment using the old method was $14,240,000. The company was losing $1.75 million per month.

On July 18, 1986 Eldridge reported to Saleh on the Interim Report on AIC. The only reason that AIC's losses to May 31, 1986 were not comparable to FIC, was that AIC sold all of its Matrix Investments Ltd. shares in a non-arm' length sale to AHL and recorded a gain of $2.6 million.

On July 23, 1986, Saleh reported to his Minister, Elaine McCoy, and to the Provincial Treasurer, as follows:

> "First Investors Corporation Ltd. (FIC)
> Associated Investors of Canada Ltd. (AIC)
>
> I attach herewith an information report on the above noted companies which I prepared in duplicate for you and for the Provincial Treasurer.
>
> I also attach two copies of our staff auditors' reports on both companies.

> Pursuant to the provisions of the Investment Contracts Act the Superintendent has a duty to take action in view of the capital impairment and substantial losses incurred by the two companies.
>
> I intend to make an offical (sic) demand to the two companies for a substantial capital injection as determined by our auditors and ask management to provide me with a budget plan and business projection indicating what measurers (sic) they intend to take in order to rectify their loss and deficit position.
>
> I request the opportunity for discussion and direction."

On July 25, 1986, Allister McPherson, the Deputy Provincial Treasurer, reported to the Provincial Treasurer, Dick Johnston, on FIC and AIC. He reported on the amount of the operating losses of the companies and provided background information on the two companies. With respect to the audit examination, the Deputy Minister reported that although the ICA was recently transferred to the Provincial Treasurer, there was an agreement that the audit in process would be completed by CCA. The Deputy Minister brought to the attention of the Minister the recent objection by the companies to the traditional method of calculating the section 8 tests. The Deputy Minister reported they would assess the audit reports when they were received, towards the end of July 1986, and would provide the Minister with further information and recommendations. The Deputy outlined that in accordance with the ICA, the Superintendent, in view of the circumstances, may suspend or cancel the companies' registration, or he may make a Special Report to the Minister.

On July 30, 1986, Michael C. Ross, Superintendent of Brokers and Real Estate in the Province of British Columbia, received a reply from Marlin with respect to a letter of July 4, 1986. That letter had requested copies of financial statements of PGL and AHL. Marlin advised that the directors and shareholders of the companies indicated that as they were private companies, they were not prepared to release the financial statements. He further stated the regulators were welcome to review, in Johnson's office, the unconsolidated financial statements of PGL. Marlin requested the companies be allowed time to complete certain transactions in AIC and negotiations with the Alberta Superintendent regarding the deficiency in FIC.

On July 30, 1986 the auditors calculated the capital impairment for FIC at $14.24 million and recommended the company be instructed to inject sufficient capital to cover this amount. They also wanted the company to provide an acceptable plan of action, which would maintain the company's solvency.

On August 1, 1986 McPherson wrote Johnson and noted that recently completed audits on the companies identified significant deficiencies in the company's capital and therefore steps must be taken to correct them. There were three alternatives:

a) The company could seek government assistance and support in some means.

b) The company could inject sufficient new capital to restore the companies to financial economic health.

c) Permit the companies to alternately fail, resulting in the investors losing all or part of their investment.

It was also outlined that the contract holders were dependent on the financial ability of the company to repay their investments, as no deposit insurance covered the contract. It was unknown whether the companies would be able to correct the capital deficiencies, however from past dealings, it was very likely that the company would object to or disagree with the calculations used to demonstrate the deficiencies. In view of the likely disagreement of the company officials on the seriousness of the situation, the regulators planned to engage an independent consulting firm to review the internally prepared audit reports, and to give comments and alternatives for consideration. Before engaging private consultants, the Superintendent of Insurance, as a matter of courtesy, was to advise the company officials in writing of their general concern and that they would be provided with an independent review of reports. Section 32 of the ICA provided for costs of such inspections or reviews to be paid for by the company. The regulators believed it was more appropriate that the government pay for the independent review. The regulators were to proceed accordingly, unless the Minister instructed otherwise.

On August 11, 1986 Saleh in a memorandum to McCoy on FIC and AIC, noted he was asked to attend a meeting with the Deputy Provincial Treasurer to discuss the companies. At that meeting, the Deputy Provincial Treasurer proposed that a formal notice be addressed to the companies at that time, and asked Saleh to prepare such a draft for discussion with the Provincial Treasurer. Saleh attached a draft to his Minister and a copy of that draft letter was forwarded to the Deputy Provincial Treasurer at the same time.

On August 12, 1986 the ASC received an application for an initial Public Offering from Principal Securities Management Ltd. ("PSML") through the law firm of Cormie Kennedy. The Preliminary Prospectus was scheduled for approximately August 15, 1986.

On August 27, 1986 the B.C. regulators noted that $1.683

million and $9.567 million had been inserted as qualified assets into AIC and FIC respectively, and registration for 1986-87 could be issued in B.C.

On September 5, 1986 Rodrigues submitted a report to Saleh on a meeting that took place on August 14, 1986 with McPherson and officials from FIC and AIC. The meeting was called at the request of McPherson and the purpose was to hand deliver the Superintendent's letter of August 14, 1986 to Marlin. McPherson advised the FIC and AIC officials that the jurisdiction of the ICA now fell under the Provincial Treasurer. The Superintendent of Insurance would still be the administrator named under the Act. Marlin was upset at receiving the letter and there was discussion with respect to the $11.3 million which was a specific reserve, and that portions of this reserve could only be released when the companies could substantiate that real estate values had increased. The companies felt that the $11.3 million PGL subordinated note had only been given to cure the disputed purchase of properties from PS&T under transaction #1, and wanted some of that note to be released and repaid because they stated that the value of the properties purchased from PS&T had increased. The Superintendent agreed, if evidence could be supplied to verify the increase. No evidence of such an increase was received.

On September 8, 1986 Johnson, PGL, again wrote Eldridge regarding FIC and the special purpose subordinated notes of $11.3 million. It was the company's hope that the properties could be released from the special reserve as soon as possible as it was critical to the calculation of unimpaired capital.

On September 9, 1986 Pat Visman, staff auditor at Treasury, wrote Eldridge and reviewed a purported injection of capital on August 26, 1986 to FIC and AIC, claimed by Marlin to cure all capital deficiencies. This was the insertion of capital accepted by the Province of British Columbia. The insertion of qualified assets was in the form of secured promissory notes, which were due September 1, 1987 by PGL, the parent company. PGL took back subordinated notes in the same amount. The assets being put in would generate no new income for the companies, and the security was described as "pledge security", that is, that the units of the mutual funds were already encumbered to approximately 50% of their market value, so that FIC and AIC took a secondary position and the comfort margin for fluctuation in the stock market was virtually eliminated. This transaction was referred to as transaction #18 in the Code Investigation.

On September 9, 1986 Eldridge reported to Saleh after having reviewed FIC's June 30, 1986, unaudited financial statements which showed the company had recorded a $5.451 million profit for the month of June 1986, after five months of accumulated losses of approximately $8.935 million. The mortgage interest income increased significantly, however, upon closer examination it was learned this was a result of a debenture held against the Prince Royal Inn in Calgary. The debenture permitted interest and losses on the initial mortgage on the property to be charged against it. Income related to this interest and losses had been recorded to June 20, 1986. As a result of default under the debenture, FIC expected to obtain title to the property on August 15, 1986. This "gain" was because FIC proposed to record the acquisition of the Prince Royal Inn at a book value representing the amount of the mortgage plus foreclosure costs and accrued interest. Eldridge had no confidence in this "gain" in value. Eldridge was very concerned again with the financial condition of the company. As pointed out previously, he questioned the amount of reliance that could be placed on the monthly statements as the regulators had experienced inconsistencies of reporting in the past.

On September 10, 1986 Saleh wrote Marlin and noted the significant mortgage income recorded in May of 1986. He drew to the attention of the company the fact that the capital impairment on $14.2 million for FIC still stood as far as he was concerned.

On October 1, 1986 Eldridge wrote Saleh with respect to the gain on the Prince Royal Inn. He recommended that FIC and AIC be instructed to have this property appraised by an independent appraiser in order to evaluate the gain.

On October 15, 1986 there was a meeting of the Deputy Provincial Treasurer, the Deputy Minister of CCA and officials of their respective departments. The questions discussed were whether or not to engage an outside consultant to review the state of affairs in FIC and AIC and if current capital in FIC and AIC was insufficient, what action should be taken by the regulators.

On October 14, 1986 the matter of FIC being an approved corporation under the Trustee Act was again raised. FIC had failed to make the required filings with ASC and the company had requested it be de-designated. The regulators wanted to know if the Provincial Treasurer considered this appropriate.

On October 30, 1986 a meeting was held between the Treasury regulators, CCA regulators, and Jim Rout of the Department of the Attorney General. Saleh raised concern as to whether the companies would be able to provide audited financial statements for 1986 and be able to avoid a going-concern note. The matter of an independent consultant to help valuate the company was again raised. The ambiguities in the capital section of the ICA were noted. There was concern with the financial stability of FIC and its low and non-income producing assets, as well as the dependency on the parent for financial assistance.

It was decided the regulators would take the business approach and involve the company's parent in the matter as the company's assets did not have sufficient earning power to support their liabilities. The regulators felt the business approach would not cause any problem with future action under the statute. Saleh and Eldridge were to prepare a paper providing the basis for having a consultant review the state of affairs of the company. It was also noted FIC was to be included in the next list of deletions of approved corporations under the Trustee Act.

On November 3, 1986 Saleh wrote Martin outlining the incidents that had occurred since the ICA was transferred to the Provincial Treasurer in June of 1986. He noted in the last paragraph of his report that it was clear the Deputy Provincial Treasurer had taken full charge and was giving direction as to what action should be taken under the Act. Under the circumstances, he complained he was acting as a facilitator and not as an administrator or decision maker under the ICA.

He continued, "...at your direction, I continue to assist Treasury officials in the responsibilities under the Act until the necessary amendments are made to formally appoint an administrator under the Act for Treasury instead of the Superintendent of Insurance".

On November 4, 1986, G. H. Kinsman, Alberta Treasury, wrote J. M. Drinkwater, Assistant Deputy Provincial Treasurer, Finance Programs, on the investment contract companies and noted there was doubt whether the contract companies' income statements were a fair reflection of these companies' economic viability. Questions had been raised as to whether they were solvent and as to whether they could be considered as going-concerns that would be able to meet their future financial commitments. Alternatives to action that could be taken by Treasury were outlined, but it was their view there were too many unanswered questions about the operations, let alone the viability of the companies, and therefore an independent analysis of both companies should be called for.

On November 4, 1986, McPherson wrote to Johnston. He outlined problems within FIC and AIC and stated they proposed to meet with company officials in the near future to express their concern more directly and seek their support in engaging an independent consultant to examine the current financial position of the two investment contract companies.

On November 10, 1986 a meeting took place between Treasury regulators and Donald Cormie, Johnson, and Marlin of PGL. The Alberta Government officials included: Saleh, Eldridge and Kalke, Assistant Deputy Provincial Treasurer, Revenue.

Initially they met with Donald Cormie, who provided them with an overview of the company and voiced a concern that Alberta officials may be feeding bad information about PS&T to CDIC. Donald Cormie had discussed those concerns with the Honourable Don Mazankowski, and apparently Mr. Mazankowski was going to look into the matter. Later, department officials met with Johnson and Marlin and outlined their concerns to them. Johnson initially reacted very strongly to the suggestion of a private consultant. After considerable discussion, Marlin and Johnson began to realize the regulators were serious and the alternative to do nothing was not acceptable. Marlin promised to call within a couple of days, but indicated Donald Cormie would make all the decisions.

On November 19, 1986 Visman wrote Pointe concerning the Principal Group's "31st Annual Review" for 1985. The review contained no reference to the audited financial statements and the regulator believed this was no oversight. The regulator stated, "I am aware that the company does not agree with the auditors' conclusions and regards the decline in value as temporary, however, the failure to disclose these facts" in my opinion, makes the review materially misleading".

On November 21, 1986, Johnson wrote Kalke and stated, "To the best of my understanding, FIC and AIC are prepared to stay within the impaired capital limits placed on them by the Investment Contracts Act of Alberta. If any loss incurred in the course of this year and next year reduces or negates unimpaired capital calculations in accordance with the Act, the shareholders in FIC and AIC are prepared to inject capital such that the requirements under the Act are met".

On November 21, 1986, a meeting of the same government regulators and FIC, AIC, and PGL officials as at November 10, except for Donald Cormie, took place to discuss the two contract companies. It was indicated that PGL representatives would support the contract companies to meet the requirements of the Act. The PGL representatives were concerned about the appointment of an outside consultant, and were concerned there might be answers that could force the government to take action that could be avoided if the government took an alternative approach. The regulators pointed out they had knowledge of the state of the real estate and other assets held by the companies and one of the avenues available to the regulator to analyze the situation was the use of an outside consultant.

On November 25, 1986, Kalke wrote Marlin stating the following: "We believe the financial situation of First Investors Corporation (FIC) and Associated Investors of Canada (AIC) is serious enough to warrant an urgent examination of their financial affairs and projections provided by Mr. Johnson in his letter of November 21, 1986. It is advisable that such an examination be conducted by an independent consultant. In recognition of the concerns you expressed about having the consultant on your premises we are prepared to allow the examination to be conducted away from your premises. All information and documentation needed for the examination would be obtained from you by our staff auditors who usually examine your companies' records.

I am sure you will recognize the seriousness of the situation faced by your companies and will co-operate with this examination."

On December 24, 1986 an agreement was reached with Price Waterhouse Limited to accept the assignment to examine the two contract companies.

On January 7, 1987, Kalke was appointed Acting Superintendent of Insurance under the Insurance Act with the responsibilities outlined in the ICA.

On February 20, 1987 Price Waterhouse submitted a preliminary report. Some conclusions could not be drawn due to incomplete information, however an interim calculation showed FIC had impaired capital in the amount of $24 million and AIC an impairment of $8.6 million. There was a deficiency in qualified assets in FIC of $64.5 million and in AIC of $22.5 million. Calculations disclosed the yield being earned on investments was insufficient to cover interest being paid on investment contract liabilities as well as the cost of operating expenses. There was a summary of recommendations which included the recommendation that the Superintendent of Insurance should suspend or cancel the companies' registration and should make a Special Report to the Minister in accordance with section 37 of the ICA. It was the opinion of the consultants that the investment contract holders would incur a loss at least equal to the deficiencies which had been calculated in the report.

On March 11, 1987, Romalo recorded a meeting between company officials and Treasury regulators with respect to the Special Review of FIC and AIC. The next step to be taken would be a meeting of Price Waterhouse, Deloitte Haskins, external auditors of FIC and AIC, and Johnson as soon as possible. Johnson could provide Price Waterhouse with further documents of appraised real estate owned by FIC and AIC.

On March 23, 1987 Pointe wrote Kalke and noted they had received an application for renewal as an issuer under the ICA by FIC and AIC. In view of the examination under way, the regulators stated they would hold the applications on file until they received direction to process and prepare the renewal certificates.

On March 26, 1987, Rout wrote Romalo and outlined what the regulators could do with respect to the issuing of registration to the investment contract companies if financial statements have not been filed. It was noted that an extension for filing under section 44 of the Act may be granted by the Superintendent.

On March 30, 1987 Rout wrote to Kalke with respect to FIC and AIC and outlined, in response to Kalke's questions, the possible proceedings that might be taken by the companies against the government if the government were to carry out some or all of the recommendations made in the report.

On March 31, 1987 Kalke wrote to Marlin on FIC and AIC and acknowledged the receipt of the companies' application for renewal of registration. Kalke enclosed the certificates of renewal effective as of April 1, 1987. He pointed out that should it appear from the audited statements, which had not yet been received, that the requirements of the Act were not being met, then the companies would be subject to cancellation or suspension of their registration and to any other steps that might be taken under the Act.

On April 6, 1987, David R. Sinclair, Superintendent of Brokers for the Province of British Columbia, wrote Kalke and stated it was essential the special consultants be permitted to get behind the balance sheet numbers of FIC and AIC to the extent necessary for them to arrive at a comprehensive evaluation and assessment of the assets. Sinclair stated that in their view, the situation could not be permitted to continue very much longer without firm action being taken.

On April 24, 1987, Romalo received a draft of the audited financial statements of FIC and AIC as at December 31, 1986. The companies did not meet the requirements of the ICA, and Romalo recommended that FIC and AIC be given the opportunity of bringing the two companies on-side by immediately injecting additional capital of $7.9 million in FIC and $5.7 million in AIC.

On May 6, 1987 regulators drafted a Memorandum for Discussion in respect to the contract companies. There were three fundamental issues of concern, and they were:-

(a) There was a significant capital and asset deficiency in both companies which failed to meet the provision of the ICA. There was serious concern over the valuation of the AHL preferred shares.

b) There was a shortfall between the liabilities and income-earning assets.

c) There was concern with inter-company loans and investment transactions. Regulators had some difficulty in understanding the business reasons for some of the transactions.

On May 7, 1987, a meeting took place between regulators for the Province of Alberta and British Columbia and representatives of the Principal Group. The following persons attended:

Alberta Government
A. J. McPherson, Deputy Provincial Treasurer
G. Kinsman, Director, Loans and Guarantees, Provincial Treasury
N. A. Romalo, Auditor
A. H. Kalke, Acting Superintendent of Insurance
J. Rout, Solicitor, Attorney General's Department
A. Wooldridge, Price Waterhouse Limited
R. Sword, Price Waterhouse Limited

British Columbia Government
E. F. Smith, Policy Analyst
D. Sinclair, Acting Superintendent of Brokers
A. Mulholland, Superintendent of Financial Institutions

Principal Group
Donald Cormie, Chairman, PGL
K. N. Marlin, President, FIC/AIC
Jack N. Agrios, Solicitor - Advisor
John W. Ryan, Coopers & Lybrand Limited - Advisor
D. L. McCutcheon, Deloitte Haskins & Sells - external auditors of PGL, FIC and AIC
R. L. Sharpe, Deloitte Haskins & Sells

A plan of action was developed at the meeting and included the requirements of a proper Business Plan for AIC and FIC, and to meet every four days with Treasury to give a progress report.

On May 15, 1987 seven scenarios were presented to the regulators with respect to FIC and AIC. These scenarios outlined the basis on which the companies might be able to continue in existence as going concerns. The format and the projections were those put forward by the companies.

On May 20, 1987, Agrios, acting on behalf of the Principal Group of Companies, wrote the Deputy Provincial Treasurer with respect to a meeting they had on May 19, 1987. Agrios outlined a number of financial statements and schedules as well as five potential scenarios relating to the future of the Principal Group of Companies and in particular, FIC and AIC. One item Agrios wished to confirm was that new investors in term certificates would be treated under a separate status, commencing immediately.

On May 22, 1987 a draft of the enforcement options available under the ICA was provided by Rout. The options were:

(a) Suspend or cancel the registration under section 10(1) of the Act.

(b) Appoint a receiver and manager under section 38 of the Act.

(c) An order be made by the Lieutenant Governor in Council under section 40, that the companies be wound up and a liquidator appointed.

(d) A combination of a) and b) or a) and c).

(e) Lay a charge under section 42 of the ICA.

On May 22, 1987 Kalke wrote Marlin. He referred to a letter dated April 30, 1987 in which he extended the filing deadline for receipt of FIC and AIC audited financial statements to May 22, 1987. After considering the further request by the company, Kalke extended the filing deadline to May 29, 1987 pursuant to section 44 of the ICA.

On May 22, 1987 a draft Declaration of Trust was forwarded by John Cross of the law firm of Cormie Kennedy, to the Department of the Attorney General and the attention of Rout. This Declaration of Trust had been drafted to safeguard money from new investors in FIC and AIC in the event of a collapse of the contract companies. The concept was that new deposits, being those after May 20, 1987, would be assured of being repaid by virtue of the monies being received on deposit being placed into, or subject to, a trust.

On May 22, 1987 the draft Price Waterhouse examination was forwarded to Kalke. The examiners emphasized the conclusions and calculations contained in the report were preliminary. They had been arrived at without the benefit of all the information which they required, and without review by the companies' advisors and auditors. With the information available, and according to the examiners calculations, the companies were deficient in the requirements under the section 8(b), (c) and (d) tests. That report stated, in part:

> (a) "It appears that any proposed resolution to the present financial circumstance must address additional capital to meet the statutory requirements, the prompt liquidation of the owned property and investment of the proceeds into earning assets and

the contribution of additional earning assets to offset the negative margin problem and to cover operating expenses. On a very preliminary global basis it appears that the Companies require an injection of capital and/or earning assets in the order of the magnitude of $150 to $200 million in order to have an opportunity to continue their operations on a potentially viable basis."

(b) "The Companies have prepared five year projections of their financial statements and cash flows under various sets of assumptions. We have had an opportunity to perform only a cursory review of these forecasts and have had no opportunity to discuss these with officials of the Companies. It appears, however, that these forecasts acknowledge that the Companies cannot continue on a viable basis without a substantial capital injection and that such capital is not available within the group."

On May 25, 1987 a document was prepared at Treasury with respect to the ICA on the effects that a liquidation would have on the assets. It was noted the possible liquidation results on certificate liabilities would be about $176 million short, which would give the unsecured creditors about 60 cents on the dollar.

On May 26, 1987 P. Visman wrote Pointe with respect to sale of mortgages and real estate from PS&T to FIC. The sale price was $9.2 million, and there was a clause in the purchase agreement which permitted FIC to rescind the agreement should the Alberta authorities raise objections to terms of the transactions. The transaction had been made retroactive to December 31, 1985, to assist PS&T with its financial statements and to satisfy the Director of Trust Companies and CDIC. Treasury's request to determine the validity of the transaction had been sent to the

Department of the Attorney General on May 19, 1987. In the regulators' opinion, the purpose of the transaction was to replace non-performing assets from the trust company with performing assets, and place PS&T on a healthier footing. This is the transaction referred to as transaction #19 in the Code Investigation.

On May 28, 1987 Agrios reported to McPherson further to meetings of May 21st and May 26th, relating to the Principal Group of Companies. The potentiality of the trust arrangement relating to new investors had still not been completed and would be reviewed at a forthcoming meeting.

On May 29, 1987, Cross wrote to McPherson, with respect to the proposed trust arrangement for new deposits. The understanding was that deposits made after May 20, 1987 would be placed into a separate segregated fund and subject to the trust. Deposits made before May 20, 1987, and renewals made after May 20, 1987 relating to deposits made before May 20, 1987, would not be subject to the same trust. There was concern the authors of the trust would be unable to certify that the proposed trust or arrangement was not subject to a review, however, they were of the opinion that the arrangement was defensible and would likely be upheld.

On June 1, 1987 Pointe wrote Kalke on the similarities and differences between FIC and AIC and other companies not in the Principal Group. An item which was included was that investment contracts were sold from the same offices as the trust company, which had CDIC coverage. Attached to this report were estimated losses to unsecured creditors of the Principal Group of Companies, if they were liquidated. PGL would have a loss of approximately $86.791 million. FIC and AIC combined would have a loss of approximately $158 million.

On June 1, 1987 an internal discussion paper respecting the financial affairs for FIC and AIC was prepared by Treasury. This report indicated investment contract holders would at best realize 62 cents on the dollar in the case of FIC, and 70 cents on the dollar in the case of AIC. PGL had $90.2 million in notes outstanding to the public at December 31, 1986. There was no persuasive rationale to continue FIC and AIC as going-concerns, hence contract holders support (if any) should be incorporated in a wind-down of the two companies. Investment contracts were compared to deposits, and it was pointed out that arguments could be made to consider investment contracts in the same position as deposits. Similarly, arguments could be made to deem the investment contracts different from deposits.

On June 3rd, 1987, a meeting was held between representatives of the Principal Group of Companies and Treasury. At this meeting a number of scenarios were produced by the Principal Group representatives providing suggestions as to how the companies could extricate themselves from their financial problems. Although Donald Cormie did not attend this meeting, evidence at the Code Investigation indicated he reviewed the material being presented to Treasury officials. (TR. Vol. 126, Page 23383-6)

On June 8, 1987 a draft report on the investment contract companies was initiated within Treasury. The report indicated that by admission of the company officials and advisors, FIC and AIC would not be able to meet all of their investment contract liabilities, therefore the businesses were not viable. FIC and AIC did not meet the requirements of the ICA. Because PGL had investments in FIC and AIC, PGL would be insolvent and unable to meet all liabilities to noteholders. The report indicated there had been extensive self-dealing among the various companies within the Principal Group of Companies. There was evidence that perhaps a third of the investment contract holders believed they were protected by CDIC insurance. The protection of contract holders vis-a-vis depositors and other investors was reviewed. The reasons for protection were:

(a) FIC and AIC were regulated financial institutions selling contracts to the public without requirement to comply with the Securities Act and without requirement to disclose financial information,

(b) FIC and AIC's contracts had evolved to a point where they were sold as alternatives to GIC's and deposit certificates,

(c) contracts had been sold from the same premises as trust company deposits which were covered by CDIC.

The reasons not to provide protection were:

(a) absence of CDIC deposit insurance was disclosed on contract forms,

b) investors were attracted by and received higher returns than on insured deposits,

c) protection had been refused to investors in other companies which had collapsed.

The report also indicated contract holders would probably receive 60 to 70 cents on the dollar on liquidation. PGL noteholders would probably only receive 8 cents on the dollar. Protection of the contract holders, supported by the Province was outlined with attendant costs. There was discussion as to whether immediate payouts to the contract holders should take place. The company had presented plans whereby the mutual fund and trust company would be the main surviving businesses. The plan was put forward on the premise that if the contract holders were fully protected, the mutual fund business could continue on uninterrupted and the values created by the business would be sufficient to meet PGL obligations to noteholders.

In a letter dated June 11, 1987, Rout reviewed for McPherson alternate regulatory actions available against investment contract companies not in compliance with the ICA. A plan was described to enable the regulators to deal with the receiver/manager option. There was also a review of the steps the Superintendent must take in order to determine, on the basis of an examination and an inspection, if section 37 of the Act was applicable.

On June 17, 1987 S. Bebenek from Treasury, reviewed the investment contracts back to their origin in the late 1960's. He noted the companies did issue single pay contracts, but stated a company should not exist solely to issue single pay contracts. If a company existed solely to issue single pay contracts, it should be regulated like any other deposit-taking institution, i.e. loan or trust companies. He pointed out that what the companies were selling predominately, at that point in time, were the single pay contracts. The 1969 Report, he said, represented a good overview of this very obscure type of security.

On June 18, 1987 Rout wrote Kalke with respect to the legal steps that would be taken in the event a receiver/manager was appointed for FIC under the ICA. Included with this document was a draft letter dated June 17, 1987 from Kalke to the Provincial Treasurer, which was a Special Report pursuant to section 37 of the ICA. In order to minimize any further deterioration in FIC's financial condition and consequent shortfall in meeting FIC's obligations to its investment contract holders and other creditors, he recommended the immediate appointment of a receiver and manager for FIC pursuant to the provision of section 38 of the Act.

On June 18, 1987 Treasury again did a summary on the investment contract companies and PGL with respect to noteholders. In the final analysis it was clear that without government support FIC and AIC would need to go into receivership/bankruptcy. It was recommended it be done on a basis that would minimize the impact on the remaining businesses in order to maximize recovery to the PGL noteholders. It was not clear at this stage whether the receivership of PGL could be avoided.

On June 19, 1987, a meeting was held in the Legislature Building and those present involved Johnston, McPherson and Kalke from Treasury and Donald Cormie, Marlin, Agrios and Ryan representing the Principal Group of Companies. The scenarios previously presented were reviewed and discussed. It appears from evidence given at the Code Investigation that this meeting ended in an impasse in relation to the support requested by Donald Cormie and the support required by Treasury officials. (TR. Vol. 126, Page 23398-99)

One might question whether the regulators should have allowed the companies to continue, even with government support. Johnston, in his evidence, stated he met with Donald Cormie to discuss support for the company. Donald Cormie would not relinquish control of the companies and therefore Johnston stated he had no alternative but to proceed in the manner in which he did.

On June 19, 1987 Treasury again outlined the steps to be taken with respect to a receiver/manager option for the two contract companies. This would include the recommendation by the Minister to the Lieutenant Governor in Council, and the appointment of a receiver/manager. The effects on PS&T and PGL were considered. The regulators considered obtaining external counsel specializing in insolvencies and communication with regulatory bodies in other areas. The Ministerial announcement and media and public responses were covered. A review of the management aspects and funding considerations in the event of an eventual depositor run was made.

On June 19, 1987 a document was prepared at Treasury summarizing Principal Group and the investment contract companies. Potential losses were estimated at $158 million to certificate holders and on liquidation they would receive 30-40 cents on the dollar. Required support costs to avoid liquidation would be between $72 to $158 million.

On June 19, 1987, Kalke sent McPherson a Special Report pursuant to section 37 of the ICA. Reports were issued with respect to both FIC and AIC. It was recommended that because a state of affairs existed of a serious nature prejudicial to the contract holders or creditors, that a receiver and manager be appointed pursuant to the ICA. This was the first step necessary for action to deal with the situation by the Minister and the Lieutenant Governor in Council. Attached was a recommendation for an Order in Council. The Lieutenant Governor in Council approved the recommendation for the appointment of a receiver/manager on the 24th day of June, 1987. The regulators had also drafted duties and authority of a receiver/manager, who would be ordered to step in and act in that capacity.

Agrios stated in his evidence before the Code Investigation (TR. Vol. 126, Page 23399-400) that a meeting was held on June 20, 1987, involving himself, Donald Cormie, Marlin and Bob Duke, counsel for Donald Cormie. As a result of this meeting Donald Cormie agreed to terms suggested by the Treasury officials at the June 19, 1987, meeting.

Later that same day, Agrios met with Johnston and McPherson and advised them of the decision of Donald Cormie. (TR. Vol. 126, Page 23402) He was advised by Johnston that a decision had already been made by Treasury that no assistance would be made available to the Principal companies. Agrios was further advised this was not a final decision as any final decision would have to be made by Cabinet. Agrios pursued with Johnston and McPherson the possible benefits of the offer of Donald Cormie, but was unsuccessful in his efforts.

On January 21, Agrios, Marlin and Donald Cormie met with Johnston and they were again advised that the decision not to provide any assistance to the Principal companies was going before the Priorities Committee of Cabinet for final approval. Donald Cormie requested the opportunity to address the Priorities Committee but the offer was declined as that would be a departure from normal procedure. (TR. Vol. 126, Page 23403)

The following day Agrios was advised of the decision of the Priorities Committee to not provide assistance to the Principal companies. (TR. Vol. 126, Page 23403)

Meetings then followed between officials of Treasury and Principal Group and a decision was reached to proceed under the Companies Creditors Arrangement Act to bring FIC and AIC to an end. It was arranged in this manner to take the necessary steps to maximize realization to investors, and was agreed upon by all parties, including Donald Cormie.

On June 23, 1987 Pointe wrote Kalke and attached memos from Visman with respect to transaction #19. Visman recommended the possibility of a reversal of this transaction be explored.

On June 24, 1987, Cross, from Cormie Kennedy, wrote Agrios with respect to making an application under the Companies Creditors Arrangements Act for FIC and AIC.

On June 29, 1987, Kalke wrote Marlin at FIC and advised him he considered transaction #19 may be prejudicial to FIC's investment contract holders, and therefore must be reversed.

On June 30, 1987 the companies presented a petition under the Companies Creditors Arrangements Act and this application was approved by the Court.

This was done by the solicitors for FIC and AIC with the concurrence of the Alberta Government. The same day, the Superintendent of Insurance cancelled the registration of FIC/AIC under the ICA.

C. CONCLUSIONS FROM INVESTIGATION

In order to understand my conclusions, it is useful to review the issues which I have investigated in this section of my report. They are as follows:

(1) Whether there was any failure in the regulatory process;

(2) If so, whether that failure contributed to any losses incurred by any person or group including:

(a) Investment contract holders,

(b) Employees of those companies (I have received a number of complaints from salesmen for example),

(c) The owners of those companies, as a result of their licence to operate being removed;

(3) If regulatory failure had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(4) Whether the regime of regulation, either the statute and regulations, or the policies and procedures developed in administration of them, or both, were faulty and should be amended.

I have no hesitation in concluding that by mid-1984, there was serious administrative error in the regulation of FIC and AIC by CCA. That error was as a result of the decision taken at the most senior levels of administration to completely abdicate rather than merely suspend the regulatory duties imposed by the ICA. The decision to abdicate responsibility was in the face of hard evidence that each problem historically identified in the operations of FIC and AIC had reached crisis proportion. It is my opinion that the action to abdicate regulation violates virtually all of the tests set out in Section 20(1) and (2) of my Act, and is clearly contrary to law pursuant to section 20(1)(a). In my opinion, no one applying the ordinary standard of common sense would fail to find it to be wrong, under section 20(1)(d).

There can be no question that CCA had the correct information, both historically and currently, about the operations of FIC and AIC. In the case of FIC and AIC, the departmental auditors were always aware in full detail of the difficulties in the operations of the companies, and carefully reported their concerns, along with recommendations for action, to their superiors. Beginning with the annual examination of the financial statements of FIC and AIC for 1980, conducted in late 1981, the audit staff continually, up to the time those companies ceased operations, identified a downward spiral of serious financial difficulty and improper practice. They consistently reported that this would produce the result that the companies could not redeem the investment contracts then being sold without the infusion of massive amounts of capital. In other words, without that capital infusion, it was only a matter of time when FIC and AIC defaulted to their investment contract holders; there being no question but that they would do so. The main concerns identified by the auditors were as follows:

(1) The companies had clearly become deposit taking companies offering single pay contracts which were virtually indistinguishable, in the public mind, from term deposits offered by banks and guaranteed investment certificates offered by trust companies. FIC and AIC, however, were operating without a borrowing to capital ratio which is the basic and necessary safeguard for such an institution, as the ICA did not contain such a requirement. The "gentleman's agreement" to voluntarily operate in that manner was continually violated and ignored.

(2) The minimum capital requirements of $500,000 and the remainder of the section 8 tests under the ICA, considered by the auditors to be woefully inadequate and needing of

legislative reform in any event, were being seriously violated.

(3) The investing guidelines under the ICA, which adopted the standards of the CBICA, again considered by the auditors to be outdated and needing of legislative reform, were being continually and seriously violated.

(4) The mortgage lending practices were risky and violated normal business practices, let alone any recognized standards applicable to a financial institution. There was no attempt to follow the second "gentleman's agreement".

(5) The mortgage portfolio itself, a large portion of the asset base of FIC and AIC, was clearly overvalued on the books of the company and on realization would leave a substantial shortfall to investors. The only route to resolution of the valuation, that being appraisals under section 29(3) of the ICA, was denied to the auditors by their superiors.

(6) The only way the companies could continue in operation would be to sell more and more certificates to infuse cash to pay off existing certificate holders, obviously a practice that would lead to insolvency at some stage. The auditors identified that this situation resulted in the sales force of PGL directing investment from PS&T to FIC and AIC because those additional sales did not have to be backed by additional capital, given the unsatisfactory capital requirements of the ICA.

(7) In spite of the above, the companies continued to sell using sales material continually approved by the department under the ICA that featured words like "guaranteed" and

"safety" and emphasized the basis of such claims was the regulation under the ICA.

The audit staff further commented on specific events of 1984 that led them to the recommendation that action be taken to prevent the companies selling investment contracts to more customers unless the problems were resolved, which only a massive capital infusion would do. The companies by 1984 had indicated a refusal to infuse capital.

These events included transaction #1, where doubtful mortgage assets were transferred to FIC and AIC in order to satisfy the more strict regulatory requirement of PS&T. They further included the shocking fact that FIC and AIC were selling investment contracts as comparable to term deposits and guaranteed investment certificates. The Principal sales force was selling additional credits as being part of the bargain and as having always been paid by the companies. The Department in fact had been informed by the companies of an intention, in January of 1984, which became a reality in June of 1984, that additional credits were not being paid on long-term investment contracts. Such long-term contracts had been selected by the companies because the failure to pay those credits would not be discovered for a considerable period of time by the contract holders involved. As well, the auditors and more senior staff had been informed by the companies that they saw no obligation, either moral or legal, to pay additional credits.

A review of the documentation prepared by the auditors, a review of their testimony at the Code Investigation, and the interviews of myself and my staff with the relevant audit staff, Eldridge, Hutchison, and Romalo, lead me to the conclusion that not only was there no administrative shortfall or error by those individuals; conversely, they continued to report diligently, thoroughly, and tenaciously in the face of a clear failure to heed, or in some instances, to understand, the reports by their superiors.

I will deal with Darwish separately, because of his lengthy involvement as Superintendent of Insurance, from May 15, 1972, to March 4, 1981, and his subsequent involvement as Assistant Deputy Minister, Program Support (later titled Program Support and Regional Delivery), which continued to involve him in supervision of the auditors regulating FIC and AIC. Again with regard to Darwish, it is my opinion that he performed appropriately and with no administrative shortfall or error. It should be noted in 1973, when he became concerned about the affairs of FIC and AIC, especially as they related to the Principal Group of Companies as an entity, he was successful in obtaining an independent evaluation by outside chartered accountants, together with a further evaluation by another independent chartered accountant and a prominent Edmonton lawyer. It appears that action did improve the situation with FIC and AIC for a considerable time. As well, an independent review by a firm of outside chartered accountants took place regarding the intercorporate fees charged to FIC and AIC within the Group.

The only criticisms that might be attached to Darwish's performance, in my view, need the benefit of hindsight. Firstly, as he testified at the Code Investigation and discussed with me, he did not press strongly for amendment to the ICA as recommended in the Shortreed/Gardner Report on FIC and AIC in 1975, because he believed the companies' situation was improving after the Report was forwarded to them. Harle, the Minister of the time, confirmed in an interview that he does not remember the amendments being pressed upon him. Secondly, Darwish, for a period of time, relied upon the two "gentleman's agreements" he thought he had reached with Marlin concerning borrowing to capital ratio and mortgage lending guidelines for FIC and AIC. If he had been successful in pressing for legislative amendment, imposing the "gentleman's agreements" and other changes suggested by Shortreed and Gardner, that could have made regulation of FIC and AIC easier in later years. However, I do not find that it was administratively wrong for Darwish to act as he did, given the times and the situation he was dealing with.

A review of regulation in other areas within Alberta during the 1970's certainly shows a general readiness to accept promises at face value, a practice that more recent experience proved to be unsatisfactory. Darwish, in 1984, went out of his way to ensure that the serious situation in FIC and AIC was brought to the attention of the Minister, as may be seen by his memorandum to Martin, of April 24, 1984, which eventually led to his leaving government service, because of the displeasure with his "meddling" on the part of Osterman.

The question then is, what could have gone wrong? No one could doubt, given the accumulation of evidence up to June 30, 1984, as presented by the departmental audit staff, that FIC and AIC were insolvent, failed to meet any of the tests under the ICA, and were now involved in practices that were highly questionable. The fact that FIC and AIC were insolvent, as the auditors believed, was later confirmed by the report of Gordon Barefoot, C.A., of the firm of Woods Gordon, tendered in the Code Investigation. If the front line staff regulating FIC and AIC did their job properly, and made appropriate and specific recommendations for action, why was action not taken?

The short answer is that Osterman communicated the impression to Martin and Saleh that under no circumstances should action be taken against any Alberta based financial institution, in fear of an adverse effect that would harm other institutions and complicate an already vulnerable situation. That is clearly the essence of their testimony at the Code Investigation, and their interviews with me. Saleh implicitly believed he could take no action without their approval.

It is my opinion that this decision to allow the companies to continue at all costs was administratively wrong, was made for mistaken and irrelevant reasons, and probably contravened the law, for reasons which I will enumerate below. The reasons for this decision, in my opinion, were faulty and arise out of a failure to initially understand and then to communicate the necessary facts and policy recommendations on the part of the two key administrative officials involved, Saleh and Martin, to the Minister, Osterman. This combined with an expectation by them that the Minister, the person least able to reach a conclusion because of the absence of such facts and regulations and recommendations, should be the one to institute, rather than approve, the administrative decisions to act under the ICA.

Prior to dealing with specifics of the conduct of those persons involved, I will set out the standards I have applied to the conduct of Saleh and Martin. It should be noted that under the ICA, virtually all responsibilities of regulation with the exception of causing receivership and liquidation of a company lie with the Superintendent of Insurance. In the case of a recommendation to undertake receivership or liquidation, a report by the Superintendent is sent to the Minister, who in turn makes recommendations to the Lieutenant Governor in Council (the Cabinet). It is clear that the Superintendent of Insurance under the ICA had the duty to act and to report directly to the Minister, no matter what the informal department hierarchy or practice was. I conclude, therefore, that the Superintendent's duty to recommend and advise, and to act, was, for the limited and specific purposes required by the ICA, at least as high as that of a Deputy Minister.

Therefore, I treat as the same Saleh's and Martin's duties to advise and recommend to Osterman.

In order to determine the extent of that duty, I interviewed a number of former and current statutory and regulatory officials, Deputy Ministers, and Ministers. I, as well, had the assistance of a recently published study authored by the Honourable Gordon F. Osbaldeston, P.C., O.C., for the National Centre for Management Research and Development, University of Western Ontario, entitled "Keeping Deputy Ministers Accountable". Osbaldeston's study was derived from more than 120 interviews with all current federal Deputy Ministers, 28 former Deputy Ministers, 11 federal Ministers and former Ministers, 8 chief political aides, and about 50 Assistant Deputy Ministers and senior officials. The results of his study, not surprisingly, conformed with my experience in my general investigations of government action, and the specific interviews that I conducted with the various provincial officials and former officials. The most important principle that emerged from these interviews, and from Osbaldeston's study, is that advice and recommendations must be given to the Minister if action is necessary or legally required, no matter the Minister's viewpoint. As Osbaldeston stated at page 17-18:

> "**Policy Advice:** The policy advice function usually embraces the development of policy options and recommendations, including the assessment of their political, financial and other impacts. There was widespread agreement among deputy ministers on the general characteristics of this role; deputy ministers are to provide policy options and a thorough analysis of the impact of these options, but it is not their role to perform politically partisan functions such as publicly advocating or defending controversial policy positions.

Rather, it is their role to explain the government's policy and thus enlighten the debate. Ministers and chief political aides generally agreed that this is how deputy ministers actually carry out their work.

Deputy ministers feel an obligation to do more than simply advise their ministers; they believe it is their duty to tell ministers what they should hear, whether they like it or not. They feel that they have a responsibility to be aware of major trends or influences that can affect the country and ensure that the minister is aware of them. For example, they must be informed of, and ensure that their minister is informed of major demographic shifts, the possibility of rapid increases in energy prices and similar developments with implications for public policy, as well as changes in client needs. Deputy ministers feel they have a professional obligation to outline the options and their implications as completely as possible and to provide ministers with politically sensitive but non-partisan advice. As one deputy minister said:

> "My relations with the minister are as good as exist around town. I've only got one aim, to see his ministry humming exactly the way it should. I made a deal with him when I came aboard. I told him, 'I am going to tell you the truth. It may not be right, but I will tell you the truth as I see it, and sometimes I won't even be polite. This is the service I can give to you. Whatever you decide to do, unless it is very offensive, I'll do it.' I've told him many times that he is wrong and he has accepted it. The key is he is using me. He is using me to get things done."

Naturally, and as a corollary to that advice, the deputy or regulatory official must himself completely understand the critical situation being recommended upon, and make sure that the Minister understands all of the ramifications of the advice and recommendations. Again, as Mr. Osbaldeston states at page 87:

> "Ministers balance four major pressures in the process of determining priorities: the need to work within the overall political process and priorities of the Government; the requirement to observe resource and legislative constraints; the pressure to respond to a variety of groups within and outside the government; and the necessity of formulating an agenda that recognizes the minister's responsibilities to carry out existing departmental obligations and requirements with respect to policies and programs.
>
> This type of agenda-setting requires extensive discussion between the minister and the deputy minister. The role of the deputy minister is to help the minister become familiar with the department and its basic needs and to provide a range of possible actions or initiatives that reflect the interests of the minister. It requires a high degree of sensitivity and responsiveness on the part of the deputy minister. The regional development case, which is outlined later in this chapter, is an example of this type of agenda-setting.
>
> Although assessing and balancing external demands is essential, ministers and deputy ministers must ensure that the pursuit of key policy or program changes does not occur at the expense of the basic functions of the

> department (for example, protecting the health of Canadians, ensuring the safety of consumer products, safeguarding the viability of the fisheries). Even if the minister's attention is elsewhere, these primary ministerial responsibilities must be fulfilled."

It is my opinion that neither Saleh nor Martin fulfilled those responsibilities appropriately; I believe this shortfall was contributed to by the actions of the Minister, Osterman.

I will firstly deal with Saleh. In my opinion, Saleh did not possess or obtain the necessary knowledge to oversee regulation of FIC and AIC, or to communicate his views regarding the regulation to his superiors, the Deputy Minister and Minister. Even if I am not correct in that opinion, it is clear that he did not make the requisite recommendations and explain the reasons for them in a manner to be expected of a senior official, much less a statutory regulator. Finally, when he did independently exercise one of the powers available to him under the ICA, he failed to do so in an adequate manner.

As an example of his failure to appreciate the nature of investment contract companies, it is my opinion that he failed to understand the significance of the decision of FIC and AIC to suspend declaration of additional credits, which was made clear in the series of meetings of June 15 - June 19, 1984, that he personally attended and as well by a letter of June 19 delivered to him by Marlin. While his audit staff clearly understood, and advised him, in the words of Hutchison, "The public is being intentionally misled by FIC and AIC in their method of handling the non-declaration of additional credits", he missed the significance of this key issue. As he testified at the Code Investigation, (TR. Vol. 157, Page 29161-2)

Q. He also appears to have mentioned additional credits not being guaranteed and being paid at the discretion of the directors.

A. That's correct.

Q. Your understanding of the additional credits was they were to be paid at the discretion of the directors?

A. That's correct.

Q. Did you understand that they had never, in the history of the companies, failed to have been paid?

A. They never have been paid?

Q. No, they never failed to pay them.

A. I can't recall.

Q. You didn't know?

A. I can't recall to say I knew or I didn't know.

Q. Did you know what the fixed rate of return on the contract was?

A. 4 percent.

Q. Did you know that the additional credit portion was invariably sufficient or in an amount that, combined with the fixed rate, would be the prevailing or slightly higher than interest rates offered by the trust companies, for example?

A. Right, yes.

Q. You knew that?

A. Yes.

Q. There's reference in this memorandum that the companies were considering not declaring additional credits for one year, and that would save them $24 million. That was brought up at this meeting?

A. Right.

Q. Was that being put forward as a solution?

A. Yes, I think the companies thought they could use this as a solution.

Q. Did they indicate to you that they had actually passed resolutions of the Board of Directors not declaring additional credits for the first quarters of 1984?

A. I don't recall.

Q. You don't recall that?

A. No.

Continuing (TR. Vol. 157, Page 29166-7)

Q. With respect to the reference to the additional credits, Mr. Darwish is more particular as to what the company was doing here in not declaring them.

He indicates at the top of 533, "The company knows about this change. Our department now knows about the change. The only people who don't know are those who are affected, namely, the investment contract holders."

He concludes, "I believe that company officials should be advised that they must inform all investment contract holders that are not having additional credits declared about this fact." Do you see that?

A. Yes.

Q. Did you act on that recommendation?

A. I don't recall what happened with that recommendation. That was addressed to Mr. Martin.

Q. Well, it was addressed to Mr. Martin, but --

A. It was copied to me, that's correct.

Q. Yes, and you're the Superintendent of Insurance?

A. That's correct.

Q. I just want to know if you recall reacting to it one way or the other?

A. I don't recall whether I discussed it with the company again, or it came in subsequent meetings with the company. At that point, I can't recall.

He also failed to appreciate the significance of the PGL sales force steering deposits to FIC and AIC and away from PS&T because of the differing capital requirements of those institutions. (TR. Vol. 158, Page 29288)

As well, he seemed to fail to appreciate that appraisals were the only method of valuation of real estate that could be statutorily used by him to determine the disputed values, under section 29(3) of the ICA. There is a memorandum between him and Darwish dated July 23, 1984, to that effect, and further lengthy memoranda between him and Eldridge in October of 1984, concerning the dispute about valuation. In spite of this, he made no recommendation, strong or otherwise, considering obtaining appraisals or protesting the order by the Deputy Minister in February of 1984 that no further appraisals be carried out. At the Code Investigation, he testified, (TR. Vol. 157, Page 29115)

Q. Okay. What was your position as to whether or not you should continue to get appraisals or not?

A. I wasn't quite sure.

Regarding advice to the Deputy Minister and Minister, the only documentary advice that he gave in 1984 was his memo of July 9, 1984, quoted elsewhere in this report. That memorandum certainly did not set out all of the problems being encountered with FIC and AIC, but only centered around the decline in real estate values as being the cause of the difficulty. Mr. R. B. White, Q.C., representing the investment contract holders, in cross examining Saleh, clearly pointed out the problem. (TR. Vol. 159, Page 29758-62)

Q. By July 9, 1984, sir, you had come to the conclusion that the companies were in a critical situation, hadn't you?

A. That's correct. That's why I recommended to the Minister that we proceed with an independent investigation.

Q. Yes. Well, let's look at your document at page 569.

Now, that document, sir -- you have that, don't you -- is a memorandum from you to Barry Martin dated July 9, 1984. Do you have that?

A. 569?

Q. Yes.

A. Just give me a moment, please. That's right, sir.

Q. In the second paragraph, you say, "All three companies" -- and you refer to the two contract companies and the trust company, right, sir?

A. That's correct.

Q. "All three companies are in critical situation." What is that kind of a situation, in a critical situation?

A. I believe I explained it here.

Q. Just explain it to us now.

A. Because of the serious mortgages arrears --

Q. No, I didn't ask why yet, I asked what is a critical situation? To use your earlier analogy, does the patient have a mild temperature or is he an extremist?

A. That patient, I explained what they have, what is the disease that they are having.

Q. What is a critical situation?

A. The critical situation is the critical financial position of the companies.

Q. How serious a financial problem is a critical one?

A. When they have capital impairment, when they don't have the proper reserves.

THE INSPECTOR: Never mind what they had, but do you mean by critical that they were near death?

A. They were in a serious situation. That's what I meant by critical. In a very serious situation.

Q. MR. WHITE: Near death?

A. Put it this way, near death.

Q. Put it this way: Would you have put any money in them?

A. No, I wouldn't.

Q. All three companies are in critical situation because of a serious mortgage arrears problem and the decline in the underlying value of real estate held as security for loans.

Now, where did you get the idea that that was the cause of the problem?

A. I got that from my auditors, the reports of my auditors.

Q. They told you that there were a whole host of other problems than that, didn't they?

A. Pardon?

Q. They told you there were lots of problems other than that, didn't they?

A. My auditors?

Q. Your auditors and the other information which you had available, sir.

A. Yes, that's correct.

Q. For example, part of the critical problem, as you have already acknowledged, was that the companies wouldn't follow the Superintendent's directions. That was part of the cause, wasn't it?

A. Right.

Q. That's not in here.

A. I believe there was a report attached.

Q. There is no reference on the footnoting to enclosures.

In any event, going through the list, one of the other causes of the problem was the absorption from the trust company of the now notorious portfolio, right, sir?

A. Right, sir.

Q. One of the other problems was the transfer out of the companies of a so-called surplus, as a result of not reserving flat, right, sir?

A. I am trying to read where is this. Where are you reading from, sir?

Q. It isn't in there, that's the problem.

A. What you are telling me that I didn't give the Minister all the information, or the Deputy Minister?

Q. I don't tell anybody in these hearings anything. I just ask questions.

You said in here that the critical situation was because of a serious mortgage arrears problem and the decline in the underlying value of real estate.

I asked you where you got the idea that that was the cause. You said it was from your auditors.

A. Right.

Q. And that one of them that I have now gotten to is the transfer out of the companies of a surplus generated by a failure to reserve flat.

A. I can't recall that one.

It was not just the decline in real estate values that was causing the problem, it was every problem that had been noticed and commented upon by the audit staff over the years of regulation of FIC and AIC had, by June of 1984, reached a crisis proportion that caused the auditors their great concern, and caused Darwish his. That does not appear to have been effectively appreciated or communicated by Saleh.

It is clear Saleh recommended, in the memorandum of July 9, 1984, and at other times, that an independent investigator be appointed to deal with the matter. It was clearly the appropriate action, and was in the end result the action that was followed during late 1986. However, it is my opinion Saleh, in effect, was attempting to pass his responsibility on to an independent investigator, and was looking for far too much from such an investigator. He stated in his testimony at the Code Investigation, (TR. Vol. 159, Page 29756)

Q. My question to you is, how many violations of the Act did it take before, in your view, an applicant became unsuitable?

A. Until I determined by an independent investigator that this applicant is not suitable.

He stated to me in my interview with him that the investigator was to be a "judge" to decide if the companies were insolvent and the licensing should be removed, and said that he was powerless to act without such an investigation. This was even though he did not believe, as the Superintendent, that the company should be licensed, as he stated: (TR. Vol. 159, Page 29599)

> Q. And, indeed, these companies were not companies that were suitable companies to be registered as contract companies as well?
>
> A. I was of that position, but I wanted to assure myself. When you say "determine", I can't determine unless I have the independent investigation in my hands. That's when I make a final determination. I haven't reached that yet.
>
> Q. All right. It is your belief in your mind --
>
> A. That's correct.
>
> Q. -- that the companies are not suitable, but you want the additional comfort of an outside consultant to confirm exactly what your audit staff is telling you?
>
> A. That's right. I want to resolve the differences between the two parties before I go ahead.

Given the seriousness of the recommendation to appoint an investigator, however, it is clear that he did not press it in a way that in my opinion would bring it home as urgent to the Deputy Minister or Minister. There are no other memoranda in that regard other than the memorandum of July 9. When asked about that at the Code Investigation he testified, (TR. Vol. 159, Page 29733-4)

A. Mr. Martin and the Minister. I was in discussion with them, not only Mr. Martin. I was in discussion with them and they told me that if we appoint an independent investigator at that time, during that period of the serious economic situation that the province is experiencing, it could cause a run on these companies, and it could cause massive losses to the investors of these companies.

They were concerned about the investors, not about the companies. And that perhaps if we allow the company to ride the storm, because there was a serious situation not only for these companies but also for other financial institutions, perhaps they can ride the storm and bring themselves on side again.

And also, there was fear about a run on the company and a run on the other financial institutions. That's what I understood from them at that meeting.

Q. Did you protest?

A. I expressed my views, but I don't protest. I express my views and I take instructions.

Q. Did you express views in opposition to the reasoning given you by the Minister and the Deputy Minister?

A. I expressed preference.

Q. Did you express views in opposition to the views given you by the Minister and the Deputy Minister?

A. I am not in the habit of opposing my superiors, but I am in the habit of expressing my preference.

Q. Did you express preferences in opposition to the views of the Minister and the Deputy Minister?

A. That's right. I expressed my preference to appoint an investigator.

Q. Nevertheless, you were told and led to believe in no uncertain terms by the Minister and Deputy Minister that their views were going to prevail?

A. That's correct.

Q. And you proceeded accordingly?

A. That's correct.

Q. And never again, while you had the power of Superintendent of Insurance, did you attempt to act in opposition to that policy and direction, did you, sir?

A. No. I don't attempt to act in opposition of my superiors' instructions.

Q. From 1984 through 1985 through 1986, what you did, sir, you did in accordance with that policy and direction; isn't that correct, sir?

A. That's correct.

Q. Knowing all the while that they did not want you to take any steps which would jeopardize the confidence of the public in these investment contract companies; is that right, sir?

A. And also the other financial institutions.

In contrast, Osterman says she does not recall Saleh ever being unsatisfied (TR. Vol. 165, Page 30987); Martin does not recall being, as he said, prodded (TR. Vol. 161, Page 30308).

Another example of Saleh not really understanding the nature of the institutions regulated, and not effectively communicating that understanding, was clear as a result of his acceptance of the rationale of comparing FIC and AIC to the other Alberta based financial institutions then in difficulty. As he stated when I interviewed him, they were all considered by him to be in the "same basket". However, as he admitted during my interview, he at no time considered the fact that FIC and AIC were the only deposit taking institution in Alberta in difficulty operating without some form of government protection for depositors, at least by late 1984. All chartered banks had CDIC protection; all trust companies operating in Alberta had CDIC protection as was required by the Trust Companies Act for licensing; Treasury Branch deposits were completely guaranteed by the Alberta government by legislation; credit unions, the largest group of problem financial institutions in Alberta, had been "backstopped" by CCA by the announcement of a deposit guarantee by the Minister on September 13, 1984. As well, the audit staff always considered FIC and AIC to be deposit taking institutions, which is in accordance with their method of regulation. Clearly Saleh shared the same view, in light of the fact he wished to regulate them under legislation which he drafted entitled "The Deposit Taking Companies Act". It is also clear that his two superiors, Martin and Osterman, considered these companies to be investment institutions rather than deposit taking institutions. I will be dealing with the significance of that later in this report.

Even when he exercised authority under the Act, Saleh did not show the decisiveness and reasoning that his senior position would require. His decision to require a change in the wording of the application form used by FIC and AIC so that the reference to the depository under the ICA was changed from the statement "The company has on deposit the required assets" to "Company is required under the Investment Contracts Act to maintain funds . . . on deposit", clearly shows indications of lack of judgment. His testimony about that matter at the Code Investigation is illuminating (TR. Vol. 157, Page 29223);

Q. Your view of the statement, "Company is required to maintain funds", your view of that statement was that that would not mislead an investment contract holder or a potential buyer?

A. That's my view.

Q. Because you say you are merely stating a statutory requirement, not representing that the statute is being complied with?

A. Excuse me, not representing what?

Q. That the statute is being complied with?

A. That's right.

Q. You say you are putting up a flag so they can inquire as to whether the statute is being complied with?

A. Yes, this is a form that could be used at any time.

Q. I know what it is, Mr. Saleh.

A. Yes.

Q. You are raising a flag that can put the investor on inquiry, is what you are saying?

A. That's correct.

His subsequent admission about the effect of that is equally illuminating (TR. Vol. 159, Page 29657);

Q. Okay, Sir, in connection with the change to the application form, you knew that the companies were using that in terms of promoting their product; that that was a material representation that was right on the face of all of their contracts, correct?

A. Correct.

He stated further:

THE INSPECTOR: You knew that the contract form had a box on the back which was required to be read to every purchaser?

A. Right.

Q. THE INSPECTOR: You didn't think that would mislead them?

A. If we say that the legislation required them to do that, I don't think I would be misleading anyone.

It must be remembered that the remainder of the words in this approved brochure and later brochures approved still contained statements such as "Safety, Security, Guaranteed," even though Saleh was now aware from his auditors that it was unlikely that the company could ever redeem its investment contracts, and that holders of investment contracts were being misled as to whether additional credits were being declared on them. The approval of these brochures, the one act that Saleh did not refer up to his superiors, but suggested during his testimony he delegated down to the persons working for him, although clearly he was involved, was an act of which it may be alleged that the Superintendent was participating actively with the companies in misleading their customers.

Unfortunately, Saleh appeared to treat his position as if he was a form of middleman between his support staff, and the Deputy Minister and Minister. It is interesting to note that the audit staff clearly understood their role, and made succinct and clear reports and strong recommendations to him, as may be seen by the excerpts quoted earlier in this report. Therefore, they carried heavy responsibility. Conversely, Saleh, who carried the heavy statutory responsibility that came to him as Superintendent of Insurance, appointed under the ICA, and further came to him by reason of his high rank, senior management status, and pay within the civil service, did not appear to understand the level of performance that was required of him. For example, there is his reaction to being told that no investigation of sales practices of FIC and AIC was to take place (TR. Vol. 159, Page 29644);

Q. By simply what, investigating false and misleading sales practices?

A. Well, if the word goes out that there is an investigation of the company, whatever it is, yes.

Q. Well, we're talking now here, sir, specifically as well, about investigating false and misleading sales practices.

A. It's a province-wide investigation.

Q. Well, sir, then Mr. Martin is telling you you're not to be investigating the sales practices, correct?

A. That's correct, and he had his reasons for that.

Q. Who else had a discussion along that line? Did you have the approval of anyone else? Did you discuss it with the Minister?

A. No, I discussed it with Mr. Martin.

Q. Mr. Martin made that decision?

A. I don't know whether he discussed it with the Minister or not.

Q. Okay. Sir, I take it you must have appreciated what the alternative was to not investigate the sales practices. In other words, the sales practices, false and misleading sales practices would continue to be carried on by the companies, correct?

A. Correct.

Q. Part of the dilemma that you faced, in terms of the overall policy decision to allow these companies to carry on, is that having allowed them to be carried on, it was a feeling you couldn't even investigate false and misleading sales practices, correct?

A. As a rule, yes, correct.

As may be seen by his seeking legal advice as to his personal position in the face of the request by the ASC for his approval of the application of FIC to make a public offering of shares in 1985, his position concerned him greatly. It is my view that by June of 1984, Saleh should have been advising the Deputy Minister and Minister on the basis that there were serious problems, that action must be taken, and that he was under serious difficulty given his position as the regulatory authority under the ICA. Indeed, he probably should have been considering at that point whether he could continue, and making that part of his recommendations. Instead, once his only request, which was for the appointment of an independent investigator, was refused, he operated without protest on a basis that any action under the ICA was refused to him, including the obtaining of appraisals, and any general action, such as the investigation of sales practices, was also refused.

He then carried out his duties on the basis of making threats to the companies, which of course were not backed up by any action. He turned his attention to a consideration of competing legal or accounting opinions, and provided he could point to an opinion from one side which differed from the opinion that he had, he felt there was little further he could do to resolve the situation. He was not prepared to rely upon his own advisors or his own audit staff, even when they pointed out to him that the arguments of the opposing side were technical only and did not deal with the basic problem of the insolvency of FIC and AIC. He seemed to adopt a "forest for the trees" attitude and concentrated on arguments as to whether the companies could maintain technical compliance with the ICA, rather than the real issue, which was that it was clear that investment contract holders now becoming involved would not be repaid.

Saleh, upon receiving a draft copy of these comments in accordance with section 27(3) of my Act, took issue with my general comments about lack of communication of hard facts and recommendations, citing his weekly meetings with the Deputy Minister and periodic meetings with the Minister. He stated he did effectively communicate in these meetings, but he believed that the Cabinet was aware of these matters and was counselling inaction. Unfortunately, without any record of these meetings, a final judgment on the adequacy of communication and recommendation is not possible. However, the Minister, as will later be seen, was adamant that she did not appreciate the seriousness of the situation. It is my opinion that, in a situation as dire as this, all parties to a miscommunication must bear responsibility.

Secondly, I will deal with Martin. Martin gave his evidence at the Code Investigation in a clear and forthright fashion, and was just as forthright in meeting with me. He stated that he believed it was the firm policy of the Minister, and of the committee of Cabinet appointed in 1984 to deal with troubled financial institutions, of which he was a reporting member, to take no action concerning any Alberta based financial institution including FIC and AIC, and to simply allow them to operate in an unfettered manner no matter what. It was clear from his evidence that because he perceived this policy, he made no strong recommendation to his Minister, or to the Cabinet, and made no effort to bring the serious situation of FIC and AIC and the serious possible consequences to the Superintendent of Insurance, who depended upon him for direction and who carried the statutory responsibility under the ICA, to the attention of the Minister or Cabinet committee.

It is clear to me, as will be expanded upon below, that the decision not to act was at least as much Martin's as that of the Minister. It is further clear to me that decision was taken as a result of some misapprehension by Martin as to the nature of FIC and AIC and their operations, from which he should not have suffered given the extensive knowledge of his audit staff and Darwish about the operations of those companies. It, as well, resulted from a misapprehension about the duties and responsibilities upon his department and himself, to the extent that it was agreed that he was in control of any action the Superintendent of Insurance would take under the ICA. While Martin stated that he was of course preoccupied with the situation of the credit unions in Alberta, which was a far larger problem than that of FIC and AIC, it is clear from an examination of his evidence at the Code Investigation and from my interview with him that he knew the situation that he was dealing with, accepted the Minister's view that the companies be left alone, and did nothing to ensure that the Superintendent's responsibilities under the ICA were discharged. This is not a case of administrative shortfall by Martin; it is a case of complete abdication of the duties of his department during a critical time.

More specifically, it appears clear from an examination of Martin's evidence that he was content to have the department operate under the direction of the Minister without making specific and detailed recommendations to the Minister about what should take place. For example, regarding agendas for meetings with the Minister, he stated during his examination at the Code Investigation: (TR. Vol. 161, Page 30148)

A. No, the agendas were a reflection of the various activities in the department, and including those items that the Minister himself wanted to talk about.

Q. Were the agendas written?

A. I don't recall whether the Minister kept written agendas or not.

Q. Well, would you have to bring material to these meetings?

A. Yes, we would know through the Minister's executive assistant what items were going to be discussed, and we would come armed with material for those particular --

It should be pointed out that throughout all the documentation produced at the Code Investigation, there is no record of any written or detailed briefing of the Minister by Martin concerning this serious situation with FIC and AIC. Had a specific and detailed verbal briefing taken place, and had the serious nature of the difficulties, and the serious implications of not carrying out the duties of the department under the ICA, been outlined to the Minister, that might be excusable. Certainly on a serious situation, the lack of a written briefing might be appropriate. However, his evidence does not support any conclusion that the required oral briefing took place.

Instead, Martin indicated that he got the idea that government policy was to do nothing about the investment contract companies because he "perceived" that policy to be in place. Examples of this "perception" are as follows: (TR. Vol. 163, Page 30585-6)

Q. Mr. Darwish, it is clear, was recommending that some action be taken, and Mr. Saleh was recommending that some action be taken.

Were you recommending that action be taken as well?

A. No, I was not recommending that action be taken. I was recommending that we continue to monitor and to follow the affairs of the company, because I believe that there was a policy of the government at the time to allow these companies to continue to operate to see whether or not they were able to work themselves out of their particular situation.

Q. So you did not recommend action because you perceived there was a policy against action?

A. That's correct, sir.

This policy was part of a general policy he perceived, and not part of any specific discussion with any of his superiors, as he stated further in his testimony: (TR. Vol. 161, Page 30179-81)

A. During 1984, I, along with officials of my department and with assistance of outside consultants and officers from the Department of Treasury devised a long-term work-out plan for the credit union. In other words, to keep the credit union system viable and in existence on the long term, and to do what we call a work-out as opposed to a liquidation or a bailout.

Q. Or a takedown?

A. Or a takedown, that's right. The word "bailout" has been attributed to that activity. I choose to refer to it as a work-out. In other words, to create a situation and to take certain initiatives that would allow the credit union to deal with its problem. Its problem was a massive inventory of foreclosed properties which had been converted from the mortgage state to the land state and non-revenue producing.

The credit union system is comprised of some 130, I believe, different independent agencies, all of whom operate independently with their own Boards of Directors. It was the policy of the Province of Alberta, with respect to the credit unions, to allow them time to do a work-out and we put together a plan of action which took the better part of a year to develop, I would say eight months, possibly, to develop, to accomplish that objective.

In response to your question, it was my belief, based on that strategy, that it was the policy of the Government of Alberta to, if at all possible, maintain the viability of the financial institutions as long as it was feasibly and humanly possible. I took that as being the policy.

Q. Was that policy given to you by way of a written directive by anyone?

A. No, it was not.

Q. Was it discussed with the Minister?

A. Yes, it was, in various forms.

Q. Put in another way, the policy is to avoid a takedown of a financial institution, if at all possible?

A. If at all possible. I think that is a fair statement, counsel.

However, the extent of the policy and what it meant is a little difficult to understand. For example, Martin stated: (TR. Vol. 162, Page 30356-58)

Q. Let me try and help you with Mr. Saleh's recollection of it. He says that it was decided because it was now December 1984 and because Mr. Marlin had assured him that the 1984 financial statements would show much better results, that you would await receipt of the 1984 financial statements and then deal with it upon receipt of those statements. Does that refresh your memory in any way?

A. Yes, it does, sir.

Q. It does refresh your memory?

A. It does refresh it, yes.

Q. Did you participate in the decision, then, to allow the capital demand to languish until the 1984 statements were received?

A. I agreed with Mr. Saleh to allow that to occur.

Q. Well, did Mr. Saleh recommend that? Is that your evidence?

A. I'm not sure whether he recommended it or not, counsel, but I think he was prepared to accept that.

Q. Well, we know what he recommended November 29th, 1984, don't we?

A. Yes.

Q. He's recommended, because he's drafted a demand letter for $24.3 million.

A. M-hm.

Q. Failing which, they would lose their registration?

A. M-hm.

Q. So we know that?

A. Yes.

Q. You're saying that you're not certain that he changed his position and may have recommended that the matter be left until the receipt of the statements?

A. To the best of my recollection, he was prepared to wait until the statements were in to see if, in fact, the company had been able to turn some of the problems around.

THE INSPECTOR: Presumably he was prepared to do that because you people -- that's you and the Minister -- weren't prepared to let him make the demand to put in the money or lose their licence?

A. We were still prepared to grant the company time to continue to exist to see if it could work its way -- a work-out could be achieved.

Q. MR. WITTMANN: That was what you and the Minister were prepared to do?

A. Yes.

Expanding on that, he stated: (TR. Vol. 162, Page 30435-37)

Q. Did you have in mind, when you said it was premature, as to what would have to happen in order to enable you to embark on any overall investigation? How bad would it have to get?

A. It is not a question, sir, of how bad it would have to get. It would be more in the nature of what action government was prepared to take relative to these companies, and to whether or not they might or might not be prepared to either provide some assistance or to provide some direction in terms of what I called the long view. In other words, the preservation of the companies over a long period of time to allow them to do a work-out.

I didn't see, at that particular time, a policy emerging from the government with respect to the preservation of these companies other than the continued activity by the regulators to allow them to exist, notwithstanding that there were -- there was non-compliance with the Act.

Q. It's more like continued inactivity, isn't it?

A. Well, that's --

Q. What activity are you talking about?

A. I am sorry?

Q. You said, continued activity by the regulators to allow the companies to exist.

A. If you want the use of the words "continued inactivity", they continued to work with the company, to continue to extend time, to continue to hold meetings, to continue to attempt to resolve issues and arrive at consensus.

Q. But back to page 297, "we consider it premature to embark on any overall investigation at this time."

A. M-hm.

Q. You have said it is not a matter of how bad it gets, it is a matter of an emerging policy or a policy emerging from the government as to the continued existence of these companies?

A. I was hoping that a policy was going to emerge.

A. But if I may, Mr. Code, draw an analogy?

Q. Sure.

A. When we started our investigations of the credit unions in 1984, I think the investigations were done with the idea that we would make every effort to provide for the continued existence of the credit unions. I think the investigations were done to establish what the depth and breadth of the problem was.

At the conclusions of the investigation, a policy was in place as to what stance the government was going to do. That was coincidental or immediately following the investigation.

Again, he stated: (TR. Vol. 163, Page 30596-98)

Q. The question is, if you are sitting in your office, you and Mr. Saleh, faced with your dilemma, and your Audit Unit says they are depressed real estate prices, we have to write down assets, the company and their auditors, on the other side of the dilemma deny that, you and Mr. Saleh have to make a judgment call?

The only thing you have at your disposal because you don't want any more appraisals, is the so-called common knowledge.

A. M-hm.

Q. The common knowledge of the day is that there has been a drop in real estate values.

I am suggesting to you that in resolving the dilemma, the common knowledge that you are working with indicates that your Audit Unit is right.

A. That's right.

Q. And in spite of the fact that common knowledge backed up your auditors, you chose not to do anything about it. You decided to let the companies have more time?

A. That's correct.

Q. You decided to take that decision, notwithstanding you had no analysis whatsoever that the companies were salvageable even if given time, that there was light at the end of the tunnel; is that correct?

A. Not at this time. It was still an aspiration that they could work their way out.

It must be noted that all of these excerpts of testimony indicated a hope, again communicated to me by Martin during my interview with him, that somehow the companies would work out their problems if they were given this additional time. However, there is no indication of any request for any business plan or work-out plan from the companies, no indication of any intention by the companies to improve the capital situation of them (indeed Martin was quite aware of the refusal to do so by the companies, and probably their inability) and certainly no indication of any intention by government to support these companies. When I put to him during my interview that continued inaction under the circumstances was inappropriate unless there was a form of support available, he stated to me "you might take that position".

Unfortunately, Martin was not only prepared to counsel inaction by his officials; he was also prepared on the basis of his perception of a policy of his Minister and, latterly, Cabinet, to prevent normal regulatory action. It must be remembered that Martin, on February 29, 1984, refused Darwish permission to have his Audit Unit conduct any further appraisals of properties owned or mortgaged by FIC and AIC, even though those appraisals were the only way to reflect realistic values, and the appraisals that were being obtained were showing huge writedowns in value. This did not seem to be part of any overall plan; on the contrary, it seemed to be a way to avoid being forced to deal with a difficult situation. Martin, when examined about that matter at the Code Investigation, testified: (TR. Vol. 161, Page 30195-97)

> Q. But you also knew that there had to be some measurement as to how much lower?
>
> A. Yes, I did, sir.
>
> Q. What steps did you take, if any, to provide or recommend alternative methods for the measurement process?
>
> A. I didn't -- I don't recall having taken any steps at the time, but to continue to urge the regulators to work with the companies to see if there was a common ground upon which they could resolve the problems of the companies.
>
> But I didn't take any particular steps. At that particular time I wasn't sure what steps to take.
>
> Q. They are saying to you, as I appreciate the evidence, and it is in here, we need appraisals to make this measurement?
>
> A. M-hm.

Q. You are telling them you are not going to have appraisals?

A. Not at that time.

Q. Right. So how did you think that they were going to make the measurement?

A. I can't comment at this time, sir, I am not sure.

Q. Did you ever discuss that with Saleh?

A. Oh, yes. Yes, we did discuss it.

Q. How they were going to measure it?

A. How we were going to arrive at values.

Q. Yes, and?

A. Well, we discussed it. Then I don't think either of us had a solution to the problem.

Q. So there is no alternative?

A. Not at this particular time. Not to the best of my recollection, sir.

And further stated: (TR. Vol. 161, Page 30197)

THE INSPECTOR: The only other factor is that the Act -- that is the only way the Act allowed the regulators to get the value?

A. I am aware of that, sir.

THE INSPECTOR: You knew that was the only way the Act would let them get them?

A. I am aware of that.

Further, Martin, once he became aware that Darwish had requested Blochert, Executive Director of Regional Services within CCA, to conduct an investigation through the regional branches of the department into Principal sales practices as a result of certain concerns, put an immediate stop to that investigation by written instructions to Blochert on May 16, 1984. In response to questions about that at the Code Investigation, he stated: (TR. Vol. 161, Page 30274-75)

Q. That's right. You anticipated it would take a form such that it would, in your words, focus public attention on these companies, erode public confidence in them, and in some way, jeopardize their continued existence?

A. That's right.

Q. Was that a concern you shared about Consumer and Corporate Affairs investigative officers investigating any complaint in regard to any financial institution at this time?

A. I think I would have reacted similarly with other companies.

Q. What if the other company is in perfectly good financial condition, very healthy?

A. Well, I am being speculative, now, counsel, in responding to that.

Q. I don't want you to be speculative, I am trying to understand the nature of your concern with a consumer complaint, and that is don't investigate it because we don't want to draw any attention to the fact that we are looking at this company, which would result in the erosion of public confidence in it?

A. Right.

Q. Why wouldn't that reasoning apply to a perfectly healthy company?

A. I guess we would have less concern about the perfectly healthy company, that it would not have had the same effect. But I wasn't dealing with a perfectly healthy company.

Q. But the effect in terms of criticism of sales practices is the same, isn't it?

A. Oh, yes. It would be Unfair Trade Practices Act.

Q. What did you anticipate the effect would be?

A. In this particular case?

Q. Yes.

A. I guess I was anticipating the worst. I was anticipating that it might create a focus of -- a focus of attention of some sort, and that could result in runs on the company, withdrawals of deposits or any adverse -- any activity on the part of the public that would be adverse to the ongoing existence of this company.

Q. How did you deal with the fact that, perhaps there may be some improper sales practices going on?

A. I guess -- no, I didn't deal with that fact, counsel.

It should be noted that this testimony shows the anomalous situation that a healthy company which has an incentive to operate ethically would be subject to investigation of its sales practices but an unhealthy and desperate company which has a clear incentive not to operate ethically would not be investigated. Such a decision defies common sense.

It is clear that Martin was completely aware of the deteriorating situation within the companies, and of the continuing difficulties of Saleh as Superintendent. He stated: (TR. Vol. 162, Page 30361)

Q. Now, his evidence on this, Mr. Martin, was that the situation was getting worse, not better.

A. M-hm.

Q. That his concern was heightened and that he, in effect, is asking you for a direction or instructions as to what to do. Do you agree with that?

A. That's correct, yes, I agree with that.

THE INSPECTOR: His evidence was that from 1984 throughout, he continually reported to you and the Minister that the situation was getting worse.

A. That's right.

It is also clear that Saleh could not take any action without Martin's approval, as he stated during his examination at the Code Investigation: (TR. Vol. 161, Page 30226)

Q. MR. WITTMAN: I think the thrust of Mr. Saleh's evidence goes further, in that he says he would never exercise a threat to cancel or suspend to licence without a direction from you or the Minister.

A. That's correct.

Q. Do you agree with that?

A. Pardon?

Q. Do you agree with that?

A. Absolutely.

Q. That seemed to be perfectly clear on this. That's in the sense that it's your decision, not his?

A. I think even further, counsel, I think it's the Minister's decision.

Q. Fair enough, but as opposed to Mr. Saleh's decision?

A. That's correct.

Q. That's how it worked in practice?

A. That's how it would work in practice, yes.

However, again, and as with Saleh, the quality and urgency of the reporting by Martin, given the situation, must be questioned. For example, as he stated during cross examination about Saleh's concerns in his responsibilities under the ICA: (TR. Vol. 164, Page 30795-97)

Q. MR. GREENAN: Mr. Martin, Mr. Saleh was examined in connection with the 1986 situation of the licences.

A. M-hm.

Q. And his testimony was:

> Q. I take, then, what you are saying is you, as Superintendent, were against the companies being allowed to sell the contracts when they didn't have a licence; is that correct?
>
> A. That's correct.
>
> Q. But you were, in effect, overruled by Mr. Martin?
>
> A. That's correct. In our meetings I was told that we shouldn't take any action to bring these companies down until we see their financial statements.

Q. Did you discuss with Mr. Martin or say to Mr. Martin, well, they are doing this in violation of the law and I am the Superintendent charged with administering the Act? Did that occur to you?

A. Well, I was telling him that we have a difficult situation in front of us. The companies are not licenced, they are selling contracts and so on in violation of the Act, yes, that's true.

Q. Let me stop there. You say we have. You had, you were the Superintendent, you had a difficult situation, didn't you?

A. That's right.

Q. And indeed, did you point out to Mr. Martin that as Superintendent you had a duty to see that they did not sell these contracts?

A. That's correct.

Q. He said to you, well, regardless it is a policy decision, we can't allow the companies to stop selling their certificates?

A. That's correct. Not in these words precisely, but that is correct.

Q. That is generally what he said?

A. That's correct.

My question to you, sir, is is that testimony of Mr. Saleh's correct?

A. The gist of that I believe correct. I don't recall specifically the discussion and the details of it, but the essence of it I think, counsel, is correct. I don't recall the specifics of the discussion, the specific wording of the discussion, but certainly we had a discussion around that issue.

Q. This is about --

A. About the licencing, about the sales practices, and about --

Q. And his problem having a duty as a Superintendent to --

A. Mr. Saleh certainly was aware of what his statutory responsibilities were.

Q. And he told you that?

THE INSPECTOR: As were you?

A. Yes, I was indeed, Mr. Code.

However, and even after the appointment of a Task Force Committee created by the Priorities, Finance and Coordination Committee of Cabinet on the 28th day of May, 1984, of which Martin was a reporting member, Martin remained unsure about any specific policy and seemed to be somewhat equivocal in his reporting to his Minister and that Committee. The following testimony is illuminating: (TR. Vol. 164, Page 30745-48)

Q. What was it that she told you that led you to believe that this was the policy of the government?

A. Mrs. Osterman never made any -- to the best of my recollection, never made any direct -- gave me direct advice that we weren't to take down these companies. We were reporting breaches of their statutory obligations. We were reporting a declining state of affairs with these companies. The information was being accepted by members of the Cabinet Committee, and we were receiving no direct instructions that it was now time to move on these companies and to commence procedures for, as I characterized it with Mr. Wittmann, takedown.

Q. Did she tell you not to take down these companies?

A. I was never told not to take them down.

Q. All right, sir, with respect to the task force, what were the discussions in the task force meetings that led you to the conclusion that that was the policy of the day?

A. I can't recall the exact discussions, but on the basis of information we were providing to them, there was no -- to the best of my recollection, there was no -- there was never any indication from the task force that we would take them down, although takedown was always an option that was -- which all the members were aware of.

Q. What was said to you in the task force meetings that led you to the conclusion that this was the policy?

A. I can't recall the exact wordings, counsel. I can only recall the overall environment of the task force, which seemed to be conducive to the continued working with these companies and the maintenance of their existence.

Q. All right, sir, let's put it this way. I'm to understand that the Minister knew exactly what you were doing with respect to these companies?

A. We were conveying to the task force financial information which would indicate the state of affairs of these companies.

Q. And the Minister knew what actions or inactions you were taking?

A. The Minister was aware of what the department was doing. We were -- Mr. Saleh and I were meeting with her regularly and she was aware of issues like investigations and the like.

Q. And the Minister was aware of your implementation of a policy to afford the companies time to solve their problems?

A. Indeed she was. Indeed the Minister and the co-members of the task force, counsel.

Q. And indeed you expressed your view that that's what you were doing?

A. I'm sorry?

Q. You expressed the view to the task force and to the Minister that that's what you were doing?

A. It's my best recollection, counsel, that the task force was fully apprised that we were continuing to meet with the company in an attempt to assist them in the resolution of their problem without government intervention.

Q. And you told the task force and Mrs. Osterman from time to time that that's what your understanding of the policy was?

A. If we didn't tell them, it was certainly conveyed to them by our actions, counsel. I can't recall exactly telling them, but our actions would certainly be consistent with that.

Q. All right. You certainly never received any criticisms for your activity or inactivity with respect to these contract companies, either from the Minister of the day or from the task force?

A. I have no recollection of ever being criticized by the Minister or the task force with respect to the position we were taking regarding these companies, counsel.

Q. And, indeed, they were fully aware of the position that you were taking?

A. I am of that opinion, counsel.

It is my opinion that this evidence indicates passive recommendation, and passing the decision on to those least capable of dealing with it, unless they were properly briefed, and given specific and succinct recommendations. I believe that this continued inactivity without those specific and forceful recommendations constitutes administrative shortfall on the part of Martin, given the tests that I have set out earlier in this section of my report.

It is my opinion that this failure was brought about in part because of a failure to completely understand the nature of FIC and AIC and their business, coupled with a misunderstanding of the purpose of the ICA, and the duties that it imposed upon CCA by Martin.

For example, Martin misunderstood the issue surrounding additional credits, although he had been personally present at the series of meetings surrounding that matter which took place between June 15 and June 19, 1984.

With regard to that issue, Darwish stated: (TR. Vol. 161, Page 30294-300)

> Q. With respect to additional credits, he says at the bottom, the last full paragraph, "In my opinion, this method of selectively deciding which investment contract will receive an additional credit is aimed at ensuring that the public does not find out that the company is no longer able to declare additional credits for all investment contracts. It was estimated at the meeting that there are approximately $100 million worth of such contracts. Company officials admitted they have not advised any contract holders of the new policy. The reason for the new policy is that there is not sufficient income to pay the expense of the additional credit. The company takes

the position that while they are not declaring additional credits, it is still their intention to pay them. This, of course, is sheer speculation."

Then it goes on on the next page, 196. "the company knows about this change. Our department now knows about the change. The only people who do not know are those who are affected, namely, the investment contract holders. While the company took the position that knowledge of the failure to declare additional credits would not seriously affect their operation, I find this hard to believe. Even so, I don't think that it is proper for the company to continue to operate on this basis and I believe it should not be allowed to sell contracts on the basis that they will pay additional contracts when they are not doing so for all contracts. I also believe that company officials should be advised they must inform all contract holders, that they are not having additional credits declared."

Now, that is his report to you?

A. That's right.

Q. What did you do in consequence of receiving that report?

A. I don't recollect, Mr. Wittmann, but I may have had a discussion with Mr. Saleh on it. I don't recollect.

Q. Did you know what an additional credit was?

A. Yes, I do.

Q. What is it?

A. It was an amount paid over and above the contract figure based on, I believe, the earnings or the ability of the company to pay.

Q. You knew at this time that since 1958 or '62 that there had never been an instance where the additional credit had failed to have been paid in the past?

A. I don't recall having that specific information about them never having paid it, but I may have.

Q. You told us about focusing public attention on the contract companies, by legislative amendment and by consumer investigation?

A. M-hm.

Q. Correct?

A. Right.

Q. Failing to pay an additional credit, did you not think that that would focus attention on these companies and bring them down?

A. It was my understanding, counsel, that the additional credits were not part of the contractual obligation.

Q. That's right. So as soon as people found out that they were getting 4 percent when they bought at 10 or 15 or 18 or 12, you didn't concern yourself with what public confidence there might be in this company?

A. I didn't put that, at the time, counsel, in the same category as the other two.

Q. What did you take Mr. Darwish's comments to mean on the page 196, when he says, "While the company took the position that knowledge of the failure to declare additional credits would not seriously affect their operation, I find this hard to believe." Isn't that what he is talking about?

A. Yes.

Q. Well, didn't you take him to be talking about that?

A. I took that to be a question of the confidence in the company.

Q. Yes. But you didn't specifically address that when you got this memo?

A. No, I didn't.

Q. Did you address the idea that the existing contract holders and people that were buying may be being misled in not to be told about this policy?

A. I wasn't aware of the circumstances under which credits were offered as an inducement to purchase the contracts.

Q. Well, what steps did you take to find out how additional credits were an inducement for purchase?

A. I didn't see that point, counsel.

Q. So you took no steps to find it?

A. Not to my knowledge.

Q. And you weren't aware?

A. Not to my knowledge.

Q. Did you direct Mr. Saleh to investigate this memorandum, or did you give this memorandum to him?

A. Mr. Saleh was carboned on this one.

Q. Did you discuss his follow-up?

A. I have no recollection of that, counsel.

Q. Did you admonish Mr. Darwish for continuing to make recommendations in an area that was not his job?

A. No, I don't believe I did.

Q. Did you regard this information as valuable information?

A. It was certainly Mr. Darwish's point of view and --

Q. We understand that.

A. It was additional information, counsel.

THE INSPECTOR: You invited him to the meeting of the company?

A. Oh, sure, yes. He was still a member of the department and still involved in the audit area.

Q. MR. WITTMANN: Now, with respect to the --

THE INSPECTOR: What about selling these contracts with additional credits when they weren't honouring additional credits at that time?

A. I am sorry, Mr. Code?

THE INSPECTOR: Well, you had advice they weren't honouring some additional credits, right?

A. Yes.

THE INSPECTOR: Yet you knew that was exactly the kind of contract they were continuing to sell to the public that very afternoon that had 4 percent plus additional credits?

A. M-hm.

THE INSPECTOR: What did you think about that?

A. I don't recall specifically, but I know I -- one of the inquiries I made was was the additional credit a matter of contractual obligation, or was it --

THE INSPECTOR: Fine, but you knew that that afternoon they were selling a contract that said we will pay you 4 percent, an additional credit of, let's say, at that date it was 6 percent. How many contracts do you think they would have sold at 4 percent with no additional credits?

A. I have no idea, Mr. Code.

THE INSPECTOR: If the market was 10 percent or 8 percent, how many savings certificates do you think they would have sold at 4 percent?

A. Putting it in those terms, very few.

THE INSPECTOR: They might have sold some all right, but didn't you think -- isn't that what Mr. Darwish is trying to point out to you?

A. I recognize what Mr. Darwish is trying to point out, sir.

Q. MR. WITTMANN: But you are not saying you didn't agree with him, just that you didn't address it?

A. No, I am not saying I didn't agree with him. I was concerned about the legality of it in terms of the contractual obligation.

Q. I am talking about the practicality of it --

A. Yes, I understand what you are saying.

Q. -- because you are the one that is expressing the concern about public confidence in bringing these companies down?

A. Yes.

Q. You didn't address that?

A. Not this particular one.

Further, and astonishingly, when I interviewed Martin I asked him, as I had asked Saleh, whether he had considered the fact that regarding deposit taking institutions, all of the competing deposit taking institutions, the chartered banks, trust companies, credit unions, and the Treasury Branches, had protection for depositors, but these companies did not. My understanding to that point had been that the possible adverse effect of enforcement on other financial institutions that had been the lengthy subject of testimony by Saleh and Martin and Osterman had, as Saleh had indicated, been as a result of putting all of those institutions in the same "basket". Astoundingly, Martin advised me that he did not consider FIC and AIC to be deposit taking institutions at all, and never had. He stated that he considered them to be investment institutions, and believed the Minister did so as well. He further stated that he had always understood it to be the policy of government, which policy had been enunciated by Osterman's predecessor, Julian G. Koziak, and which policy had developed as a result of the difficulties with the collapse of Dial Mortgage, that the government under no circumstances would offer financial support to an investment institution but only to a deposit taking institution. When I put to him that that made the entire flavour of his testimony at the Code Investigation suspect, in that he continually seemed to hold out hope for some sort of plan by government to be communicated to him by the Cabinet committee so that the situation with FIC and AIC should be stabilized, he had no responsive answer. The Minister, when I interviewed her, was also of the belief that these institutions in her mind were investment institutions.

It is interesting to note in the Code Investigation what the evidence indicated with respect to people who purchased investment contracts. The evidence showed that safety was a priority. The President of FIC and AIC, Marlin, confirmed this as well. (TR. Vol. 74, Page 13311)

> Q. Again, then, sir, in summary, in talking about this area, when we are talking about people purchasing these contracts or these contract holders, these were people who didn't play the horses or the mutual funds. As far as your profiles indicated they were savers, weren't they?
>
> A. Yes, they were savers. They were people who had not been involved in investments that had equity base or there was a risk in.

In my view, this basic misunderstanding was integral to the decision to suspend regulation of FIC and AIC in the face of their difficulties from early 1984 onward, and is clear indication of administrative shortfall and failure. There can be no doubt that by 1984, FIC and AIC were deposit taking institutions, selling deposit products undistinguishable to the public from bank term deposits and guaranteed investment certificates of trust companies, and that was well known to all of the employees involved in the regulation of those companies in CCA up to and including Saleh. I also believe that this misapprehension resulted in Martin (and probably as a result the Minister) misunderstanding the duties of CCA and specifically the Superintendent under the ICA.

Investment regulation generally connotes the provision of adequate knowledge to the investor; it is then for the investor to make the investment decision. That is the scheme under which the Securities Act operates. Conversely, for a deposit taking institution, the legislation connotes provision of information and compliance with certain standards to a regulatory body, without provision of financial information to the public. Although the ICA was deficient in the tests and requirements, it clearly involved the department in requiring a level of financial solvency to meet the requirements to allow companies to sell investment contracts.

The purpose of the ICA was to protect the purchasers of investment contracts. Unfortunately, as Saleh testified, Martin's purpose was to protect the companies selling those investment contracts, specifically, FIC and AIC. Martin, when he testified, also added the further purpose of protection of the general health of Alberta based financial institutions. If there is any doubt that was Martin's purpose, the following passages from his testimony at the Code Investigation should be considered: (TR. Vol. 161, Page 30218-220)

> THE INSPECTOR: Well, tell me this, sir. Was any consideration given to those people who would put money into these institutions?
>
> A. The subsequent investors?
>
> THE INSPECTOR: Yes.
>
> A. Oh, I think there was always a concern that monies were continuing to flow into these companies during this uncertain period. There was an awareness of that, sir.
>
> THE INSPECTOR: I mean, you knew that was happening?
>
> A. Yes, I did, sir.
>
> THE INSPECTOR: But what concern about their investments at this time tied to turn around the companies' fortunes?

A. I guess, if I may, sir, there was concern about the old money and the new money. You're talking about the new money?

THE INSPECTOR: Yes.

A. The old money was there. We're talking about the new money. I think we're all concerned about the continuing flow of new money into the companies.

THE INSPECTOR: But I gather that's all it came to was a concern, that no action was taken to protect, in any way, as you call it, the new money?

A. The only action I guess, sir, concerned was to remove the licence of the company and to prevent them from carrying on business.

THE INSPECTOR: You're saying that's the only action that was possible?

A. I think so.

THE INSPECTOR: Well, it's possible, for example, this amendment to get additional capital requirements. Wouldn't that help them?

A. I guess if the companies were still in existence, I suppose so, sir.

THE INSPECTOR: Well, I mean if they were that shaky, then surely the new people had some protection coming, too, didn't they?

A. Well, that could have been considered.

THE INSPECTOR: I mean, if you're saying that any kind of a movement to change anything was going to bring them down, well, the people that are putting money in should have some notice of that, shouldn't they?

A. That's a fair comment.

THE INSPECTOR: Or they should be prevented from taking new money.

A. I understand your comment, sir.

THE INSPECTOR: Good. But nothing was done about it?

A. That's correct.

(TR. Vol. 161, Page 30280)

THE INSPECTOR: I see. So what consideration was given to the future purchasers in that decision?

A. Well, I don't think I gave any consideration in making the decision to future purchasers. I was more concerned about the ongoing existence of the company.

THE INSPECTOR: Right, okay.

(TR. Vol. 164, Page 30887-88)

THE INSPECTOR: Did you think that the government had a responsibility to the new investors who put money into an institution that the government knew wasn't complying with the Act and were hoping would some day, with a return of the market, would be back to compliance?

A. I won't speak for the department. I think there was a risk attendant on that, counsel.

Q. MR. DUKE: Well, sir, that was the gamble, so to speak, that you spoke of in answer to my learned friend, Mr. Davidson's question?

MR. MCKALL: Risk.

A. The risk.

Q. MR. DUKE: Well, let's use the word "risk." You knew there was a risk and I won't belabour the questions which my friends have so properly asked, but did you, sir, in your discussions with your members of your task force address what would happen if things did not turn around, so to speak?

A. I don't recall a specific discussion on that point, counsel.

Q. Well, you say a specific discussion, sir?

A. I don't recall a discussion on that point.

Q. Did you discuss doing a workout for the institutions if things didn't turn around?

A. We didn't discuss doing a workout at that particular time. The hope was still, as I understood it, that the economy of the province would turn around and that given a healthier economic climate in the province, the companies would be able to work themselves out of the dilemma. To the best of my knowledge, there was no suggestion at that time of the words, and I use your words, of a bailout.

(TR. Vol. 162, Page 30414-15)

A. Secondly, the land that was supporting those investments had declined in value. Our experience when we go back, and if I may, sir, go back to the Dial Mortgage situation, when that was taken down, the assets of Dial were insufficient to meet the obligations to their various investors.

It was my opinion, and I believe it was the opinion of the committee, that the continued existence of the companies at least didn't foreclose the opportunity for either (a) the survival of that company or -- and these are my own words and not attributed to the committee -- the possible intervention of government. Once they were taken down, they were down.

THE INSPECTOR: Okay, well, I can see that, but that still doesn't answer my question about the viability of the financial institution. You are hoping the land comes back and a loss might not be as great as it might otherwise be, but that is not really saving the company, is it?

A. I guess, sir, it is minimizing the possible loss to the investors. It may not be saving the company.

THE INSPECTOR: The present investors?

A. The present investors.

THE INSPECTOR: The investors at the moment, right?

A. Yes.

THE INSPECTOR: But not the future investors?

A. No, of course there was always that concern about the monies that were coming in.

Martin did appreciate that he was risking other persons' money, as he testified: (TR. Vol. 164, Page 30789-91)

Q. And you were less concerned with the nature of their investments and the sales practice and the intercorporate goings on as you were with ensuring that the companies could continue to survive?

A. I was primarily concerned with the continued existence of the companies, counsel.

Q. All right. Mr. Pointe (sic), you accepted my friend Mr. Greenan's suggestion that in hoping that things would turn around for these investment contract companies you were taking a bit of a gamble?

A. Oh, I think we all appreciated that there were risks attendant on this decision.

Q. And my friend Mr. Greenan referred to it as a gamble, and I believe you accepted that characterization?

A. It was certainly a risk, sir.

Q. And I take it that an element of gambling is having something to lose? You would permit that, would you?

A. I think that is a common accepted practice of gambling, of horse racing and everything else.

Q. And I take it that there was certainly no expectation on the part of your department at any time that the government would ever bail out these companies?

A. The question of bailing out these companies or giving these companies financial assistance had still not arisen.

Q. All right. I take it, would you permit, sir, that you were, in effect, gambling with other people's money?

MR. MCKALL: I don't think that's a proper suggestion for this witness.

THE INSPECTOR: What's that?

MR. MCKALL: I don't think that's a proper suggestion for this witness.

THE INSPECTOR: Why not?

MR. DAVIDSON: I think it's a fair question.

THE INSPECTOR: If they're gambling, whose money are they gambling with?

MR. MCKALL: He said risk.

MR. DAVIDSON: He said gambling.

THE INSPECTOR: Well, was he taking a risk with other people's money, if you want to put it in those terms.

Q. MR. DAVIDSON: Did you understand, sir, that you were taking a risk with other people's money?

A. I understood that the Government of Alberta was taking a risk in permitting these companies to continue under the circumstances.

Q. Did you understand they were taking a risk with other people's money?

A. I understood that other people's monies were involved in this company.

Q. Only other people's money?

A. Pardon?

Q. Only other people's money?

A. Yes, the investors' money, yes.

If the reasoning that such a gamble was necessary to protect the deposit taking financial institutions in Alberta is correct, all of those other institutions had deposit insurance by either the federal government or provincial government, ie., the federal government in the case of the chartered banks and trust companies, the provincial government in the case of the Treasury Branches and credit unions. If a serious reason for this policy of inaction was fright about a run on all Alberta based deposit taking institutions, the effect of the policy was that government was using the funds put up by the purchasers of investment contracts from FIC and AIC for another purpose from which it itself could benefit, that of preventing a run on those institutions the deposits of which government had already agreed to guarantee. None of the persons to whom I have directed comment in this section of my report considered that aspect of the policy however.

In summary, if there was a specific policy enunciated by a Cabinet committee of the Government of Alberta and communicated to Martin that under no circumstances would any action be allowed against FIC and AIC, to have fulfilled his role appropriately as the senior administrator involved, he must be able to testify or to show through documentation that he specifically and forcefully made the Minister and the Cabinet committee aware,

(a) of the difficulties,

(b) the serious nature of the duties and responsibilities under the ICA,

(c) the ramifications of the decision not to take any action, the effect of which was to grant carte blanche to those companies to embark on an intensive selling campaign of investment contracts which his department advised him could never be redeemed, and

(d) to seek specific instructions.

As I indicated with regard to Saleh, receiving those specific instructions might well result in Martin having to take a very serious decision as to whether he could continue, given his admission that he in effect controlled Saleh's actions under the ICA. In contrast to those requirements, here is what he stated regarding government policy: (TR. Vol. 162, Page 30320)

A. It was the policy to continue to give them time, sir.

Q. All right, and it was the policy not to hire an independent consultant because that may attract public attention or public focus on these companies.

A. That's correct, sir.

Q. That occurred not only July 9th, 1984, but thereafter continuously?

A. It was a continuous position.

(TR. Vol. 162, Page 30321)

A. Oh, to continue to work with the company to see if a work-out could occur.

Q. Without any government assistance?

A. At that particular time, that's my recollection, sir.

Q. That was predicated, at least in part, on the hope or the expectation that the real estate market would recover?

A. That certainly was part of it, yes.

Q. Was that any more than a hope, anything more than a hope?

A. Well, it was a hope, expectation.

Q. Well, did you have economic studies that gave you that expectation?

A. No, I didn't have economic studies, but I think it was a reflection of the general hope of the Minister and the members of the executive counsel that a turnaround would occur.

Q. Did anyone during this time frame instruct a study be done of FIC and AIC to ascertain whether they would survive even if the real estate market came back?

A. Not to my -- I have no recollection of that, sir.

Q. Did you consider that?

A. No, I didn't.

This rather casual method of reporting appeared to continue throughout the time of Martin's involvement with FIC and AIC. For example, after Osterman's portfolio was changed on February 5, 1986, and a new Minister appointed, on February 6, 1986, Al (Boomer)

Adair, the serious issue arose that because the financial statements for 1985 were not provided by March 31, 1986, by FIC and AIC, they in effect were operating without licences under the ICA, because Saleh refused to release the licences until the financial statements were received in compliance with the Act. This was unprecedented in the history of those companies. When examined extensively as to whether he had brought that matter to the attention of the Minister, Adair, Martin stated this: (TR. Vol. 162, Page 30492-93)

> Q. You have no recollection, despite your concern the two contract companies were carrying on unlicenced in April 1986, of bringing that to the attention of Mr. Adair?
>
> A. I had concern about that, but to say --
>
> Q. Did you tell him about it?
>
> A. Pardon?
>
> Q. Did you tell him about it?
>
> A. I don't recall, counsel, but that doesn't mean -- we may not have advised him in the course of the briefing. But I don't recall specifically and to say that under oath.
>
> Q. Well, you don't recall any instruction from him?
>
> A. My recollection of instruction was to carry on as we had in the past. That is my recollection, sir.
>
> Q. But in the past you had never failed to issue the licence to the contract companies, had you?

A. No, we had not.

Q. All right, so this is new?

A. That's right.

Q. It's a departure from previous years' practice?

A. Yes.

Q. It's a departure concurred in by you on Saleh's recommendation?

A. To grant to May or whatever the --

Q. To grant an extension to them for applying, and write them a letter saying they're not getting the licence until May?

A. That's right.

Q. So that departure was not approved by the Minister, or if it was, you can't recall?

A. I can't recall, counsel. I can't recall.

The Minister, Osterman, in her testimony, which will be reviewed in detail later in this Report, stated that she never received any hard advice or recommendations for action at any time, and a good bit of her concern was based on perception and "intuition".

It is of course not possible to say whether information properly understood and properly communicated to the Minister and the Cabinet committee might have changed the situation.

Martin, upon reviewing a draft copy of these comments in accordance with section 27(3) of my Act, took issue with these conclusions. He insists that at all times he was operating in accordance with policy set by Cabinet and his Minister. As I indicated regarding Saleh, without independent evidence or record as to the discussions of his meetings with Cabinet Committees and the Minister, no final judgment on the adequacy of communication is possible. However, as the Minister is adamant that the seriousness of the situation was not brought to her attention, and that she did not order inaction, all parties to such a serious miscommunication must bear responsibility.

I will now deal with the administrative actions of the Minister, Constantine Osterman. Osterman testified at length, and it is my opinion that her testimony, and my interview with her, further supports the criticisms that I have made of Saleh and Martin.

Osterman was very forthright in her testimony that from the time she took on her portfolio, there was one crisis after another with financial institutions in Alberta. As she stated at the Code Investigation: (TR. Vol. 165, Page 30934-35)

> Q. And from that point on, in terms of the financial institutions that you dealt with, both within the regulatory jurisdiction of the Consumer and Corporate Affairs and generally, how would you describe it from 1980 through to 1986?

A. Are you talking about the overall atmosphere?

Q. Yes.

A. One crisis after another. I think that it is fair to say that there were times when I felt that I was standing in the middle of a financial battlefield and trying to priorize the patient that we would minister to first.

Q. And was the first patient the credit unions?

A. That's right.

Although during her testimony she made no complaint about the type of information she received from Saleh and Martin, it is clear from an analysis of her testimony that she did not understand the gravity of the problem with FIC and AIC, and she continually stated that the flavour or emphasis of the information which she did receive would not have led her to conclude this was a crisis situation. She specifically denied that some information reached her, under cross examination.

For example, she stated in dealing with Saleh's request to appoint an independent investigator: (TR. Vol. 165, Page 30987-88)

Q. ...After he summarizes the history of what has gone on and basically the real estate valuation issues, what he is required to do under the Investment Contracts Act, he says, "I would request the Minister's permission and yours to solicit outside professional advice from a firm of chartered accountants of the Minister's choice, for an overall assessment of the financial position of FIC and AIC based on proper valuation of their assets and practices and at the companies' expense." Now, Mr. Saleh's evidence, and I believe Mr. Martin's evidence, was that that was discussed with you at this time?

A. Yes.

Q. And did you take the position at this time that that investigation should await, as I understand your evidence, the legal advice that you were seeking?

A. Yes.

Q. Legal advice on what?

A. There were a number of questions that I understood were outstanding, and one of them being assets held outside the country and whether they could be considered for the purpose of the capital test of the Act, this type of thing.

Q. Okay. The evidence also is in terms of this outside consultant issue, and we will come across it again, is that Mr. Saleh, I believe, describes this issue as always being on the table and that you and Mr. Martin were still considering it and this goes on through 1985. Is that how you would describe?

A. No, I don't believe so. I would have taken that the legal discussions or opinions were a prerequisite to the next step. I guess I considered this a part of a process because I was already walking through that process in terms of having outlined a course of action for the credit union system, and we had what I think could be called a collegial relationship. I do not recall Mr. Saleh going out of a meeting saying I am dissatisfied that we haven't done this or that or something else.

Again, regarding the seriousness of the advice, she stated later in her testimony: (Tr. Vol. 165, Page 31083-85)

Q. Well, was there any discussion about the idea that with the capital impairment or deficiency, the contract companies were in breach of the statute, violating the law?

A. I don't know -- it was a very gray area in terms of the discussions about what pertained in terms of the ongoing ability for the companies to operate, and because I felt that there had not been clarification of the company's position in terms of capital impairment, I did not pursue questions in that regard.

Q. There was never any occasion to your memory, then, when a discussion occurred about giving the companies time in the context of, while, you are giving them time, they are in breach of the statute?

A. No. I believe that that would be described by the regulator, if necessary.

Q. What do you mean described by?

Q. Well, Mr. Saleh would say to me that something had occurred that absolutely put the company in a position where we must take their licences.

Q. Well, he did report, if you look back at page 105, that there is financial difficulties and transactions that are in contravention of the Investment Contracts Act.

A. Well, fair enough, and I can refresh myself there in terms of Mr. Saleh may have spoken to me in that regard, but we regulate a lot of areas and not always is every i dotted and every t crossed, and I suppose it would be fair to say I wouldn't have had an appreciation of where cumulatively, because it is not just a matter of you were speeding or you weren't speeding, where we finally reached a point that the regulator felt that the licences had to be withdrawn.

Q. But would you rely on "the regulator", you are referring on the Superintendent of Insurance, I take it?

A. Yes.

Q. Your evidence is you would rely on him to say enough is enough; you are capital deficient and we have to give a compliance letter that says put up or you will lose your licence?

A. Yes, and I would have expected him to explain to me the nature of this being the condition that then put the companies in that position.

Q. I don't understand that answer.

A. Well, because the nature of the capital area was predicated for the most on the real estate area --

Q. Yes.

A. -- as I understood it, though there were other things that began to come into the picture, I guess it was my view that I would have had communicated to me the rationale for that. In other words, Mr. Saleh would have said, Madame Minister, this has to occur because, and he had not said that.

Indeed, regarding matters like transaction #1, she stated: (TR. Vol. 165, 31087)

Q. MR. WITTMANN: Well, at the risk of putting words in your mouth, you sensed non-cooperation?

A. That's right.

Q. And you derived that sense from what Saleh and Martin are telling you about what is going on?

A. Precisely.

Q. And did they tell you about the intercompany transactions, for example, beyond the first transaction which you became familiar with?

A. In late '85, I recall, just in a discussion way, coming to the conclusion, and I used the term "hanky-panky." I said it just looks to me like there is some hanky-panky going on here and I don't like it, and that went beyond the arguments between the professional auditors about what was appropriate. It probably is, to some degree, Mr. Code, unfair of me to say that. I have no hard evidence

> about this, except to say that I had to rely on some intuition, and we had certainly been looking at this question for a long period of time, and I was not satisfied with the way things were going.

And further: (TR. Vol. 165, Page 31090)

> THE INSPECTOR: Well, that's the machination, but you hadn't really been told of it, your intuition told you about it. They hadn't told you about these deals that Mr. Wittmann just mentioned to you?
>
> A. Right, except that they felt that -- there were concerns about the kinds of intercompany practices, but they were not enumerated upon.
>
> THE INSPECTOR: They didn't tell you exactly what those intercompany practices were?
>
> A. That's right.
>
> Q. THE INSPECTOR: When I say "they" I mean Mr. Saleh and Mr. Martin?
>
> A. That's right.

Osterman, late in 1984, given the specific and detailed concerns of the auditors, should not have had to rely upon her "senses" and her "intuition". She should have been given hard facts and recommendations to deal with. The fact that she was not appears to be borne out by a report which was entitled Alberta Financial Institutions which was presented by Martin on November 11, 1985 to the Task Force set up by the Priorities Committee of Cabinet to deal with problem financial institutions. Osterman chaired that first Committee, the members of which were Lou Hyndman, the Provincial Treasurer, Neil Crawford, the Attorney General, Julian Koziak, the Minister of Municipal Affairs, Allister McPherson, the Deputy Provincial Treasurer, and Martin, the Deputy Minister of Consumer and Corporate Affairs.

It is interesting to note Osterman's testimony regarding that report: (TR. Vol. 165, Page 31094-97)

Q. Now, attached to this report is a document entitled Alberta Financial Institutions November 18th, 1985 at page 160?

A. Yes.

Q. And the parts that we have excerpted relate to Principal Savings & Trust Company and the investment contract companies. That information would come through your department?

A. That's right.

Q. And that would be provided to Mr. Hyndman for the purpose of making his overall report?

A. Yes, in other words, I would provide such information from the regulators' perspective.

Q. And with respect to the reference to Principal Savings & Trust Company Current Status Report at page 161, there is a reference that the real estate and mortgage balance figures reviewed to June 30th were highly optimistic.

Approximately 50 percent of the mortgage portfolio is in arrears six months or more. And that information would be reviewed by Mr. Pointe, I take it?

A. Yes, I am sure it would have been.

Q. And the information with respect to the investment contract companies that is provided at page 162 and 163, after outlining the calculations of the department's auditors and the dispute indicating that management or the companies argue they're in a surplus rather than a deficit position, there is reference not only to the size of the depositors, $417 million at the bottom of the page, but it concludes "Unless there is a significant improvement in the Alberta real estate market, the department is concerned that these two companies might not be able to meet their medium term obligations to their contract holders. Should the final determination of the outstanding legal and valuation issues prove to be unfavourable to the two companies, the situation may call for the suspension or cancellation of the registration of the companies unless the principals have the financial resources and the willingness to cover the deficiency. It is possible that the regulators might have to invoke the provisions of the Act with respect to receivership or liquidation of the two companies in the circumstances." That report went to Priorities Committee, and the Premier is the chairman of the Priorities Committee?

A. Yes.

Q. That statement that I just quoted to you from the Investment Contract Companies Section indicates that the concern was such that it was almost time to start developing an action plan?

A. Yes.

Q. And that is the plan that you say you would like to have before you embark upon an independent consultant investigation?

A. Yes, I think that I would want some concurrence from my colleagues in terms of options available to us, if one has to be at least partially prepared in the event that you end up having to call the licences or whatever.

Q. All right. But by the time this report is issued, you have told us that you have concluded that management is not or intuitively you think management is not cooperating, you are being provided with some information that there is some hanky-panky intercorporately but not specifics, and your report here or your departmental report references fairly serious steps. In other words, it is a warning that there may be a receivership or liquidation coming up here unless the outstanding issues are being resolved in favour of the companies?

A. That's right.

That report was in turn sent to the Priorities Committee which was chaired by the Premier. It is interesting to note that it does not contain the graphic and specific concerns of the auditors, or of Darwish, which had developed more than one year earlier, and still leaves the suggestion that the situation has now become difficult but not yet critical. She testified further: (TR. Vol. 166, Page 31195-96)

Q. And in terms of the discussion, it indicates that the mandate of the task force you chaired was to review the impairment facing financial institutions governed by provincial statutes and bring forward a plan of action. Do you see that?

A. Yes.

Q. And what plan of action did you bring forward with respect to AIC and FIC between May of 1984 until February of '86?

A. I did not. It was the credit unions that we dealt with first. So I did not -- we did not deal with a plan of action, so to speak, for the two companies that are under discussion here.

Q. Do I take it from your answer that your preoccupation was with the credit unions and you didn't have an opportunity to get around to the AIC and FIC for the purpose of a plan of action?

A. Well, it was -- if I had believed that there had to be a plan of action developed as well, I would have put forward that view, Mr. Greenan. But in terms of what I would say for my part, more absolute belief, it was the credit unions that were critical.

Q. Fine, but in terms of the mandate as I read it, it is talking about bringing forward a plan of action with respect to financial institutions governed by provincial statutes. We are clear that AIC and FIC fall under that category?

A. Absolutely.

Q. And the mandate you had didn't exclude any plan of action with respect to those two entities?

A. No, that's right.

Q. And I take it you are saying that you just didn't have the opportunity to bring forward a plan of action, that is you or the task force?

A. I didn't believe that a plan of action was necessary at that time.

Regarding being advised about specific violations of the ICA, she denied that she had been so advised by Martin or Saleh. She testified as follows: (TR. Vol. 166, Page 31285-88)

Q. MR. GREENAN: And specifically what I'm interested in here, Mrs. Osterman, is the notion of the companies carrying on business when there's non-compliance with the Act. That's the point I'm dealing with. Turning to line 8: (explanatory note: this is an excerpt from the testimony of Mr. Martin)

"Q. You were aware, sir, that Section 31 provided that no company should issue investment contracts for sale unless they had the reserves and the necessary deposits, correct?

A. Yes, I understand that. I see, yes.

Q. You understand it now, but you certainly were aware of that in '84 onward?

A. Yes, I was aware of their deficiencies.

Q. And, indeed, from '84 onward, you were aware that the companies didn't have the reserves and didn't have the deposits?

A. I was aware from information received from our auditors and from Mr. Saleh that there were deficiencies.

Q. So in any event, somewhere the decision was made that regardless that they didn't meet the requirements of Section 31, the companies would be allowed to stay on in business?

A. That's correct.

Q. That was part of the policy?

A. That's correct.

Q. In other words, the policy, in effect, was even though under the Investment Contracts Act they were prohibited from issuing investment contracts, we take a larger view of things, the policy says, let the companies carry on and sell the contracts?

A. Yes, I would agree with your characterization of the larger view.

Q. That's the type of discussion, as well, that would have come up in discussions with the Minister and the task force?

A. To the best of my knowledge, counsel.

Q. Yes. You're agreeing with me? You say to best of my knowledge; you're agreeing with me?

A. Yes, okay.

Q. Sir, in the course of your discussions with members of the task force, at some point did you or Mrs. Osterman say, well, we've got a problem in that the law prescribes something under the Investment Contracts Act, how do we deal with this in terms of the policy? Did that type of discussion come up in terms of --

A. I don't recall that type of discussion coming up in those, counsel. But I recall discussions coming up regarding them being -- and I think the words were 'offside'. I'm not sure, but I think those were the words, were offside.

Q. Did it personally concern you and did you raise the concern with Mrs. Osterman about the fact that the Act indicated the companies couldn't sell, but the policy decision was, in effect, circumventing the Act?

A. I was concerned about the fact that the companies were in operation notwithstanding their deficiencies. Yes, I was personally concerned about that." (End of excerpt from Martin's testimony)

Q. Do you see that?

A. Yes, I do.

Q. And in connection with that testimony, is it correct in terms of discussion about the companies being prohibited from issuing investment contracts and that type of discussion having come up with yourself and the task force?

A. No.

Q. So you're just disagreeing and saying that discussion did not occur?

A. No, we did not talk about the companies in that respect.

On further questioning by White she stated: (TR. Vol. 167, Page 31495-96)

Q. Did he let you know in writing, in talking through your executive assistant, by a memo, hand signals, innuendo, a wink, a nudge, I don't care how, that he was of the view that these companies at some of the time at least were operating contrary to the Act. Did your Deputy Minister do that?

A. No. He would have used the term "may".

Q. How do you know that, Mrs. Osterman?

A. Because I recall that he was not -- I did not believe him to communicate that he was firm in his judgment, therefore we needed opinions.

Q. Now, are you saying to us that he did not do that or wouldn't have because you know his manner of speaking? I don't understand your answer.

A. I am saying that he, in expression about an opinion, when giving an opinion, ordinarily he would say, they may be. And I am talking now -- or I am speaking now about generally in his communication to me about areas that require an opinion, and I don't believe that he was wanting to express a legal opinion, so he would usually use may.

Q. His testimony here, so you are aware, under oath was, I was aware; I was aware that the companies were in non-compliance with the Act. Now, did he say that to you?

A. No.

She also denied that it was ever conveyed to her that these two companies were insolvent and were using customer deposits to pay off existing investment contracts. She testified: (TR. Vol. 166, Page 31304-06)

Q. Did Mr. Martin and/or Mr.Saleh convey to you the fact that FIC was virtually insolvent?

A. No.

Q. Did you conclude that yourself based on any other information in 1984?

A. Well, certainly at all times I knew that the auditors had a view of the companies' situation, and again I come back to the two views that were provided to me. And so how that was -- that view was continually sustained came by various bits of information. In other words, I certainly was aware that the department had not changed their view.

Q. And in terms of what the department's view was that was being conveyed up the line, did you understand the department was saying that they were insolvent?

A. I was understanding that the department was saying that they did not meet their capital requirements.

Q. Well, indeed, you mentioned earlier by sums of in excess of $70 million with respect to the three tests?

A. At one point that's what I gather they believed the amount was.

Q. And who would convey that information to you, would it be Mr. Martin?

A. Mr. Martin.

Q. And what about the fact that they had severe capital shortage, obviously you were being told that?

A. That's right, and I do not recall the precise figures that were communicated, but they may have been given over.

Q. And also conveyed to you by Mr. Martin that the company, in the case of FIC, was losing $1 million a month from operations and was dependent on new customer deposits to pay off existing customer deposits and to subsidize the companies' losses? Was that conveyed to you as well?

A. No, I don't recall that.

It is clear that Osterman counselled inaction regarding the companies, given the information that she had. She resisted any suggestion that she forbade action, but did agree that she did not see the need for it and was highly concerned about the effect on the companies in taking action. She certainly did agree that action could not be taken by Saleh without her being informed and impliedly without her permission. In that regard, she testified: (TR. Vol. 165, Page 30946-48)

Q. And what I am leading up to, Mrs. Osterman, is the letter that was dispatched at page 25 to the FIC president, and the reason that is in your exhibit is that the evidence of Saleh and Martin is that a compliance letter such as this would not be written without the approval or the blessing of the Minister and the Deputy Minister is the way the evidence has come forward.

A. I am not sure what blessing would mean, but I certainly would want, and this is now harking back to the major work that was being done on the credit union system, I would want the information at hand that there was going to be what I called at the time a "now hear this" letter, which could lead to some future activity that would have a ramification for all of the financial institutions. The credit union system at that time was some 500,000 depositors and approximately a $2.6 billion system which reached into every corner of this province, was incredibly fragile, and while that was only once in a while alluded to in the press, it certainly was of grave concern to us because there was some knowledge in the public about it, and so financial institutions such as this, if we can describe this organization that way, anything going out that would trigger a -- some legislative action, I would want to be aware of.

Q. Well, your awareness of the Investment Contracts Act, in terms of result, did you have an understanding that there were certain capitalization requirements in the statute?

A. Yes, I was.

Q. And you would rely upon Mr. Saleh or Mr. Martin with whom you dealt directly as to telling you whether the contract companies were deficient or not?

A. Yes.

Q. And this letter, in paragraph 1, begins with the observation that First Investors has substantial capital impairment of 35.3 million as outlined in the attached schedule. I want to know if that knowledge was your knowledge at the time the letter was dispatched?

A. I can't remember the precise figures, Mr. Wittmann, but I do know that it was reported to me that the view of the auditors, and I believe of Mr. Saleh, was that there was an impairment. And I also had, in terms of discussions, gleaned from various officials in the department that over time these particular companies and others under the trust company, under the Principal umbrella were always very argumentative about information that came from the department. It would be challenged and it would take some time to settle those challenges, if indeed they had been settled.

Q. With respect, though, to the concept that we are dealing with or I think we have to come to grips with, Mrs. Osterman, is the idea that a statute provides certain requirements as to capital. The compliance letter, so-called or, as you put it, the "now hear this" letter, says according to our calculations, you people are in non-compliance with the statute, in violation of it. You understood that?

A. Yes, I did.

Q. Now, is there any suggestion that a policy could override the statutory requirements?

A. No.

Q. So when you met with Martin about a "now hear this" letter, your concern was not that it wasn't or may conflict with any policy but that the effect of non-compliance and ultimately the demise of one of these institutions may have on the whole area?

A. That's right.

She stated further: (TR. Vol. 165, Page 30950)

Q. Going back to this letter, there is also evidence at these hearings come forward through Mr. Saleh and Mr. Martin that there would be no threat made of the withdrawal or suspension or cancellation of the licences without your approval?

A. That's right. I would want to know. I don't believe that -- I would hope that it wouldn't have been construed that I would block that. If the information came forward that there was absolutely no alternatives, that a work-out was not available, I would have wanted to have that opinion so that I could bring options to my colleagues, very much like the credit union system. But, at that time, it is fair to say that I would not have had that in the process of my thinking, that I would have to address options at this point in time.

In furtherance of that position, Osterman clearly concurred in Martin's decision to call off Blochert's investigation of the sales practices of FIC and AIC. She testified: (TR. Vol. 167, Page 31393-96)

Q. Mrs. Osterman, I would ask you to turn to page 30710 of the transcript. This is examination of Mr. Martin. Beginning at line 2:

"Q. And the statement that all the assets were deposited with the Royal Bank and that if First Investors had problems the Royal Bank would pay the depositor out, that would be false?

A. That would not be a correct statement.

Q. In fact, it would be false and misleading?

A. Yes, it would not be a correct statement.

Q. Do you have a problem saying it's false and misleading?

A. No.

Q. And the Royal Bank is the trustee for all the money. If there was a problem, they would take over and distribute out the money. That was --"

it says always, I think it could be also, -- false and misleading?

A. That's correct.

"Q. Now, I gather at the time you say you made the decision not to go ahead with this investigation, shortly thereafter you made Mrs. Osterman aware of your decision not to proceed with the investigation?

A. Yes.

Q. And she agreed with your decision?

A. Yes.

Q. And what discussion did you have with Mrs. Osterman about why you should not go ahead with the investigation?

> A. I don’t recall the specific discussion, counsel, but it would be somewhat akin to the discussions we would have about sending investigation teams into the company and the possibility of those activities becoming public and being disruptive to the stability of it and other companies.″

Q. Is that testimony of Mr. Martin’s correct in terms of the discussion with yourself about why you should not go ahead with the investigation?

A. I believe that overall I would say that’s a fair recounting because he uses the term investigation teams and so on. It was expressed to me as if it was a very large investigation as opposed to looking at the conduct of a salesman initially.

Q. And if we go back to page 30710, Mr. Martin is asked about these representations, for example, involving the Royal Bank. We should not take it from that record that he communicated to you the specifics in terms of the Royal Bank?

A. No.

Q. In effect, then, you are saying that information, if he knew it, he didn’t communicate it to you?

A. I certainly don’t recall it one way or the other but I do recall it being described as a -- it maybe assumed more than it should, but it seemed as if it was going to be a major investigation and not a specific salesperson’s conduct.

It was also clear that Osterman was not prepared to approve the appraisal of real estate either owned by FIC and AIC or on which security had been taken by those companies, nor was she prepared to approve any independent appraisal of the companies by an outside chartered accountant as was requested by Saleh. Her reasoning can clearly be shown from the following excerpts from her testimony: (TR. Vol. 165, Page 30996-98)

> Q. But specific to my question, the soliciting outside professional chartered accountants to do an overall assessment, go in and have a look, was that not done in part because of the consideration of the fact that public attention might be drawn to that with the result in loss of confidence?
>
> A. When I would come to the conclusion that that was necessary, it would be -- I would want to have a firm opinion, at least held in my own mind, about the viability of the institution, and I realize that that would be making a personal judgment without additional advice, but I believe that to be important because the credit union system was, in fact, in the same situation. If we're going to have a massive investigation, I would want some understanding, and that would come, as well, from discussions with my colleagues, whether they were going to support me in whatever options I might develop in a preferred option that I might put forward with respect to any institution that we were regulating.
>
> Q. Well, with respect --
>
> THE INSPECTOR: Would you ask the question again, Mr. Wittmann.

Q. MR. WITTMANN: With respect, that doesn't answer what I asked you.

THE INSPECTOR: We will move along a little better if you answer the questions that you're asked, Mrs. Osterman.

A. I thought I did, but I'll try again.

Q. MR. WITTMANN:This goes to Mr. Martin's evidence is that it was a factor in the deliberations as to whether or not to bring in an outside firm of chartered accountants for an overall assessment, that by doing so that would necessarily focus public attention on the investigation or assessment with the fear that that may cause a run?

A. That's right, and in my view it would have been premature because I had not formulated options.

Q. Okay. But premature or not, was the idea of focusing public attention part of the reason why you didn't do it at this time?

A. I think we're both saying the same thing.

Q. I'm not saying anything. I'm just trying to ask you --

A. I thought you were.

Q. Well, pardon me. I'm asking you whether that was part of the consideration in the decision not to call in outside professional chartered accountants, the fact that that may draw attention to this institution?

A. Partially.

Q. So it could -- it was a factor?

A. It could be, yes. I won't say could be, it was. There was some consideration, and it was to do with timing.

She further testified: (TR. Vol. 166, Page 31118)

Q. And if you'll forgive me, one answer you gave to Mr. Code I don't believe was responsive. When he asked about why or what you were doing to measure the value of the real estate and mortgages during this time frame, and you talked about precipitous action, the measurement or the valuation you wouldn't regard as precipitous?

A. No.

Q. It would be if that valuation determined that there was concurrence with your internal auditors, then you would have to act?

A. Yes.

Q. So again, I ask you, did you not act because of what the answer might be?

A. I felt that the answer that would come back about real estate overall was obviously going to be down. I mean, we were looking at -- it was self-evident for anybody who had a piece of property, anybody that owned a home and had to sell it. Many times their mortgages were higher than the value of their property. And I believed that at that time, with very little market in which to do the market valuation of an appraisal, that it would be an unfair time to weigh that part of it, give so much weight to that aspect of the companies' operation. If the company is operating properly --

Q. Mrs. Osterman, we have to hear from you exactly what you're talking about here because your evidence could be taken two ways: One, that appraisers are not reliable because they don't measure the true value at the time; or that the true value of the time is not a fair measurement of value to apply to these companies. Now, which is it?

A. I didn't believe they could get a true value.

Q. At the time?

A. At the time.

Q. But you've just told me that everybody knew the market was down and the values were down?

A. Precisely.

Q. So you knew the answer you would get?

A. But if you were forced to sell, as many people were who were moving or who lost their jobs and had to walk away from their homes, you would have had fire sales all over the province. That's why the mortgage corporations properties were held off the market. We had already involved ourselves in the marketplace.

Q. I understand a little bit about that, but hear me. Value, whatever it might be is out there, you would agree with that? It may be difficult to measure, but it's there, and that's the problem that you were faced with is what is it?

A. Yes.

Q. Doesn't it come down to that? What is the real value at the time?

A. I didn't believe it was an appropriate time to measure.

Q. Well, that's what I'm getting to. Not believing that it's an appropriate time to take the measurement is different from not measuring it because you don't believe you can get the real value.

A. Well, I think that if you were to have candid discussions with appraisers, as I did, they would tell you that at very best they're doing a guesstimate.

Q. Even today?

A. Yes.

Q. That's part of their methodology, is it not?

A. Yes, but the guesstimate was much higher at that time.

Q. Well, I don't want to belabour this, but I gather what you're telling us, when you didn't believe it to be the appropriate time, is that the market was severely depressed?

A. I didn't believe that we had very many willing sellers out there, which is what I understood to be a condition --

THE INSPECTOR: Buyers, maybe.

A. Either.

Q. MR. WITTMANN: Okay, so that goes to lack of market?

A. Yes.

THE INSPECTOR: Lack of a market.

Q. MR. WITTMANN: Lack of a market. So because there was a lack of a market, you determined that the value could not be measured, period?

A. True, in my view, yes.

Q. And that's why you didn't get appraisals?

A. That's right.

Q. But you knew that the audit people had to measure it somehow to do the statutory tests?

A. The outside auditors had already done, obviously, some measurements.

Q. But hear me. That may be obvious to you, but the details of that are unknown to you, are they not?

A. That's right.

Q. You don't know how many appraisals the outside auditors got, what methodology they used in accordance with accounting principles to do their valuations or any of that sort of thing?

A. No, I would take it for granted that as professionals they are charged with doing the very best possible.

Q. By some method?

A. Yes.

Q. And you didn't know what it was if it wasn't appraisals?

A. That's right.

She further testified: (TR. Vol. 167, Page 31362-64)

Q. Did I understand correctly that it was also a term of the condition that the outside consultant was not to be obtained until things stabilized in terms of the Alberta economy? Or was that only with respect to appraisals?

A. It was only in respect of appraisals because consultants would have to get appraisals.

Q. Mrs. Osterman did you understand that if the outside consultants were brought in in the summer of 1984, they would, no doubt, simply confirm what the Audit Section was telling you anyway about the large write-downs and the deficiencies?

A. I believe, Mr. Greenan, that I have answered that question about appraisals.

Q. Well, I am sorry, you will have to forgive me?

A. I did not believe --

Q. I am talking about outside consultants?

A. No, I am trying to say that outside consultants would have to get appraisals. That was my view. They would have to get appraisals to do their overall look at the company in terms of its viability. The company's viability. And probably more far reaching than just with respect to FIC/AIC. We had a trust company under Principal, insofar as the public was concerned, I believed that the Principal umbrella for public consumption seemed to cover all of their companies, and I believed that an outside consultant, as had been my experience before, at least to garner some basic information, that I could rely on to take to my colleagues in terms of any type of work-out plan, they would have to have appraisals.

Q. All right. So the issue of the outside consultant tied in with the appraisal issue?

A. Absolutely.

Q. And you would have to have the economy stabilize in order for the outside consultant to be brought in?

A. To be assured, that's right.

And further: (TR. Vol. 167, Page 31370)

Q. One of the logical consequences was that the outside consultants were simply going to come along and confirm what the Audit Department had already said which might trigger something with respect to the ongoing existence of the companies?

A. Mr. Greenan, the consequences would be, in my view, that I, if they believed that the outside consultants had to be brought in in order for the regulators to fulfill their responsibility, I would have to be preparing a plan related to these companies.

Q. What was the problem with preparing a plan?

A. There wasn't a problem preparing a plan.

Q. Well, then why --

A. I did not feel that I had to at that time. I would have, obviously, as I had done in two other cases, prepared a plan for the companies.

Q. And how extreme did the situation have to get in terms of AIC and FIC? What would cause you to do a plan at that time in 1984?

A. Well, it would be with a firm understanding of where the companies stood financially.

Q. And, again, it all goes back to the appraisals, the outside consultants would have to be involved with appraisals and get back to the same question?

A. I believe I said that, Mr. Greenan, yes.

It may be seen that Osterman's reasoning is, unfortunately, circular in nature. In other words, she states she could not take action until and unless her regulators could be unequivocal about the shortfalls in the companies. However, she was not prepared to allow them the only tools available to them under the ICA, that being appraisals, or an independent investigation, to become unequivocal. There were to be no appraisals, because she believed them to be unreliable based on her general experience. There was to be no investigation of sales practices, because that might focus attention on the companies. There was to be no independent investigator, because that might do the same. It is my opinion that properly worded or presented facts and recommendations concerning FIC and AIC, such as were being presented to Saleh and Martin by the auditors and Darwish, might have changed matters. However, whether it would have or not, it is my opinion that administratively it is inappropriate and improper for the Minister to make the decision to do nothing given the nature of the responsibilities of the Ministry under the ICA, and the large numbers of depositors who were convinced to place their savings with FIC and AIC after 1984, when the front line regulators in the department believed (correctly) that the companies could not repay those contract holders.

The main administrative shortfall is that Osterman may have conveyed, and Martin and Saleh may have perceived, a policy that nothing was to be done concerning FIC and AIC no matter what. In that regard, she testified: (TR. Vol. 166, Page 31256-66)

Q. MR. GREENAN: I ask you turn to page 30180. That is Mr. Wittmann examining Mr. Martin.

A. Yes.

Q. And if you go to the bottom of the page, 25 and 26, there is a preamble, but I think specifically it states:

> "In response to your question --"

This is Mr. Martin's testimony --

> "In response to your question, it was my belief, based on that strategy, that it was the policy of the Government of Alberta to, if at all possible, maintain the viability of the financial institutions as long as it was feasibly and humanly possible. I took that as being a policy.
>
> Q. Was that policy given to you by way of a written directive by anyone?
>
> A. No, it was not.
>
> Q. Was it discussed with the Minister?
>
> A. Yes, it was, in various forms.
>
> Q. Put in another way, the policy is to avoid a takedown of a financial institution, if at all possible?
>
> A. If at all possible. I think this is a fair statement, counsel."

Q. So in connection with discussion with you and Mr. Martin, did you, although maybe not necessarily using the exact words, did you make it clear to him that it was the policy of the Government of Alberta to maintain the companies ongoing as long as it was possible?

A. We dealt with the companies on a company-by-company basis, Mr. Greenan, and I wouldn't say there would be -- there was not "a policy". We talked overall as a government of wanting to have a good financial industry in the province.

Q. I am just trying to deal specifically, however, though, with your discussion with Mr. Martin and his impression of what you conveyed to him about this policy.

A. Well, Mr. Martin would have seen already two independent actions. In fact, he would see some work on the third. And that was first Paramount, which was handled in one way. Credit unions handled in another way, Heritage handled to some degree in a third way. And so, again, I am not sure how you construe a policy out of that.

Q. Let me ask you to turn, then, to page 30366?

A. Yes.

Q. Again, this is Mr. Wittmann questioning Mr. Martin at line 8. Do you have that?

A. Yes, I do.

> "Q. Is it your evidence, then, that according to your perception, that you and she --"

And that is yourself and Mr. Martin --

"would be influenced by the advice received sitting on the task force as to how to handle individual problems dealing with companies regulated in Consumer and Corporate Affairs?

A. It would be points of view that would be considered, sir.

Q. So there would be some influence exerted?

A. Yes, if you wish to use word 'influenced.' I think that's fair.

Q. Well I don't wish to use it if it is unfair, Mr. Martin. Influence is influence. Did it have any effect on your decision-making?

A. The effect that it had, as near as I can recall, sir, to continue the process of monitoring these companies and continuing to grant them an opportunity to exist and, hopefully, the opportunity to turn their situations around. It was part of, I believe, of that what I have described previously, as what I perceive to be the policy.

Q. So the influence or advise you received on the task force was to give the companies more time, don't do a takedown?

A. I think that's fair.

Q. Is Mr. Martin correct when he states his understanding of the policy derived from the task force with respect to the companies.

A. No, and is Mr. Martin talking about these companies here? It seems to me that he is talking about a perception of the task force not these companies, as I am reading this.

THE INSPECTOR: No, he is talking about these companies specifically, and that is found in line 23 at page 30366, and when he says these companies he is talking about the investment contract companies.

A. Well, the company --

MR. WITTMANN: Or the companies at line 12 in the question.

A. Yes, because I am referring to how the question got started and we are talking about companies regulated by the Department of Consumer and Corporate Affairs and then he goes on to say "these companies" and so I think that there is some question about it. I read it differently than you, Mr. Code.

THE INSPECTOR: I heard him to be referring to FIC and AIC. Now, I may have misunderstood that and perhaps a careful reading of this means that it was all of the companies under the -- so that this was the policy for all of the companies under the Department of Consumer and Corporate Affairs. Okay.

Q. MR. GREENAN: So in connection with the task force, if that was the policy with respect to the financial institutions generally --

MR. MAJOR: Mr. Greenan, I hate to do this, you know that, but he says he perceived it to be the policy. That is Mr. Martin's perception of what the policy is, so let's not make the jump to it being the policy. If you want to talk about Mr. Martin's perception of policy, that's what his evidence is.

Q. MR. GREENAN: I think that is fair. He only sat on the committee for a year and a half. If that's his perception, I guess that's all we can say.

A. Well, Mr. Greenan, I think that Mr. Martin has a perception, and you will see by the various things that occurred with respect to other companies, that obviously that perception, I am not sure how it occurred, but it wouldn't hold because we did different things depending on the situation with respect to the company. And in terms of the task force influence, I would certainly hope that I would be listening to whatever information was provided by my colleagues, as would he.

Q. MR. GREENAN: Mrs. Osterman, I would ask you to also look at page 30651. This is in the course of Mr. Martin's examination.

A. I have it.

Q. Beginning at lines 25 and 26.

THE INSPECTOR: What page?

MR. GREENAN: 30651.

Q. MR. GREENAN: Beginning at lines 25 and 26.

"Q. Mr. Martin, we'll just go back to the earlier area that we were dealing with, and that was the policy enunciated to you as you understood it.

A. Yes.

Q. At page 30220 --

A. I'm sorry, I missed it, counsel.

Q. At page 30223, you were asked questions again regarding the policy, line 19. Question -- Mr. Wittmann to you:

Q. All right. But I want to put this in the context of your interpretation of what the policy directive coming from the Minister was. That's to allow these companies, the contract companies, time to work out their policies?

A. M-hm.

Q. To avoid a takedown?

A. Right.

So in any event, the Minister again is involved, that would be Mrs. Osterman, in terms of articulating a policy regarding a takedown?

A. Yes, that would be correct."

Q. And did you have a discussion with Mr. Martin or the task force articulating this policy of avoiding a takedown?

A. No.

Q. So Mr. Martin is just wrong on that point?

A. Certainly in terms of his perception. I don't think he says here that -- is he saying here that he believes that we had a discussion with respect to that?

Q. Well, I will tell you what, we will carry on to page 30653 and this does go back to the earlier transcript reference where Mr. Wittmann was talking about influence of the task force. Do you recall being referred to that?

A. Yes.

Q. And if you carry over to page 30653 at line 18, after being referred to that testimony the question is,

"Q. So in any event, what you're saying in connection with the articulation of this policy is that although you cannot put your finger specifically on a member of the task force articulating the policy, aside from the Minister, Osterman, I had mentioned, that certainly was what was being said in the course of these task force meetings, correct?

A. That was my perception.

Q. The basis for this strategy, this policy of giving the companies time, was all predicated upon, to use your expression, a great deal of hope and prayer, correct?

A. Those were my words, sir.

Q. The hope was that there would be a turnaround in the economy that somehow might have an impact on improving the companies' positions.

A. Yes, sir, yes."

Q. So in connection with that, was that the policy? That is, namely, giving them enough time on the hope that the economy might turn around and have a positive impact on the companies? I am referring now to AIC and FIC.

A. Mr. Greenan, I would characterize the situation by once again saying that from my view, I would be talking about the time in terms of establishing that the economy had stabilized wherever it was going to stabilize.

Q. But we are talking about AIC and FIC insofar as the policy goes, correct?

MR. MAJOR: Her perception of policy. I hate to keep sounding like a broken record.

Q. MR. GREENAN: In this case, I am asking the Minister, I am asking Mrs. Osterman if she had that understanding of the policy?

A. There wasn't a policy.

Q. There just wasn't a policy. That's the answer?

A. There was not a policy. We dealt with the companies company by company, and in the case of the two companies under discussion, I have indicated to you what my approach was and we can spend, again, as many pages as obviously was spent here on trying to get a perception here. But I am telling you, as Minister, what it was that I articulated with this company, and it was obviously a different articulation in terms of other companies depending on the circumstances.

Q. That's exactly what I am interested in. What was the policy or what was the directive with respect to these two companies, AIC and FIC, in terms of giving them time?

A. The time related to the stabilization in the Alberta economy and I could not predict, while looking ahead things looked somewhat better, I could not predict where the economy would be when we -- when it was stabilized in our view.

Q. So you were going to give them time on the expectation that there would be a stabilization of the Alberta economy; is that correct?

A. That's right. I felt that the information that then would come forward on the companies would be more accurate.

Q. And this expectation --

THE INSPECTOR: Is that not a policy? Pardon me, I don't understand that. You say to your Deputy Minister and the Superintendent, I don't want to know the values of these companies until I am satisfied that there has been a stabilization. Isn't that a policy?

A. Well, Mr. Code, it may be but I am somewhat nervous. I hear Mr. Greenan talking about policy, and policy for him seems to sweep everything in the world into it and I am trying to now take it and make it specific to this company. If you want to call it a policy, it is a policy.

THE INSPECTOR: I don't want to call it anything. I am just asking, isn't that, in fact -- if you say to your Deputy Minister and the Superintendent, look, I don't want to know the values of these companies until the economy is stabilized, and that might take 2 or 3 years, isn't that a policy?

A. I would call it a condition of the information and development that we thought we needed.

The same confusion about policy appeared to apply to Saleh. Regarding him, she testified under cross examination by White representing the investment contract holders: (TR. Vol. 167, Page 31506-11)

Q. What I am suggesting to you, Mrs. Osterman, and the answer may be you agree or you disagree with what I am suggesting, but I suggest to you that whether it is a policy, a practice, a decision or plan, I don't care what it is called, before Mr. Saleh could undertake an investigation under Section 32 of the Act, he had to have your approval irrespective of questions of cost? That's true, isn't it?

A. I don't agree with the word "approval".

Q. What word would you prefer?

A. It would depend on the -- maybe we should look precisely for this. You are talking about this memo and not a general policy?

Q. We have spoken of this specific request which was for an overall assessment of the financial position of FIC and AIC based on proper valuation of their assets and practices and of the company's expense. Section 32 of the Investment Contracts Act empowers the Superintendent to authorize any person to conduct an examination and inspection of the companies' affairs and to charge any fees he considers proper for such inspection.

My suggestion to you is that Mr. Saleh, however, could not do that without obtaining your approval, right?

A. No, that's not right.

Q. Totally uncategorically false?

A. He would -- I would be expecting of him to carry out what he had to do to exercise his regulatory responsibility.

Q. All right. Now, he is asked that he be allowed to undertake such an investigation. We know that such an investigation was not undertaken and are you able to tell us why?

A. Well, when Mr. Martin and Mr. Saleh and I, back when this was generated, and this now goes back to July 9th, 1984, we had a discussion. I don't recall seeing the memo, but certainly we had a discussion. Mr. Saleh did not say to me, I am required to do this because of my regulatory responsibility.

Q. Whether he said I am required to do it, whether he said I would like to do it, whether he said I want to do it, whether he said please may I do it, he didn't do it. Can you tell us why?

A. He obviously, in discussion in terms of the three of us, concluded in our discussion -- I asked about, obviously asked about what the longer term was and what the whole thing would entail. Again we talked about appraisals and Mr. Saleh did not communicate that it was impossible for him to do his job because --

Q. Can you tell us why this wasn't done?

A. I cannot say why it wasn't done. Obviously Mr. Saleh did not believe that it was absolutely necessary or he believed inappropriately that regulation of the Act was going to be a matter that the Minister undertook.

Q. Now, as I understood your testimony, you didn't have a chance to read Mr. Saleh's evidence, so I must tell you that he has testified that he needed your approval first and he did not get it. I need you to know that.

A. I understand from earlier conversation that he has expressed his view that approval was necessary.

Q. And that seems to be a word which sticks in your craw. What word would you prefer to approval? Concurrence, blessing, go-ahead, nod?

A. There are two different streams of --

Q. Just what word, Mrs. Osterman? Time is running.

A. I realize that, Mr. White, but I think --

THE INSPECTOR: Mrs. Osterman, we have lots of time. You be certain you know what you are answering, don't be rushed, all right.

MR. WHITE: I hope that applies to my questions as much as her answers.

THE INSPECTOR: I know Mr. Major has said it, but we have milked that one long enough, so let's not have the witness here be under any impression that we are forcing her to answer fast and out of time.

Q. MR. WHITE: How about responsively?

A. Mr. White, I want to be as explicit as I can. So if there is a misunderstanding that Mr. Saleh is operating under, then I do not know on what basis he and I and Mr. Martin are having the discussion, because I am under the understanding that we are having a discussion, that if there is a regulatory function to be performed, it will be performed.

Q. Are you able to direct us to any Minute or memorandum, and document at all in which you give a direction to Mr. Saleh that if he feels it necessary to proceed as requested in his memorandum on page 95 he might do so?

A. I didn't have that memorandum. So the answer is no.

Q. He requested in his meeting that he might do so?

A. As discussed in his meeting, no.

Q. Now, I am obliged as a result of earlier testimony, Mrs. Osterman, to suggest to you that you refused him permission. Do you accept my suggestion?

A. No, I do not. There was a discussion and what I believed to be a consensus reached.

Q. I am obliged further to suggest to you that the reasons given by you for him not proceeding in the manner suggested were because of a general economic downturn, because of similar problems in other financial institutions, because the companies should be given the time to get on side, and because of a fear that an investigation might cause a run on these companies that could reciprocate a domino effect on other institutions with which you were dealing. As a result of earlier testimony, I am obliged to put to you that that's what you said to him?

A. Certainly all of those matters that you have enumerated upon could have been the potential happenings if an investigation became public that occurred. But, again, in my view, there are times when these things must occur, in any event.

Q. Were you of the view in July 1984 that you were prepared to let them happen?

A. I wouldn't have had a choice had they had to occur.

Q. I agree in law. But what was your view at the time? Were you prepared to let those things happen?

A. I wouldn't have been prepared to let those things happen in that I would have wanted at least an attempt on some type of plan for the companies if that -- if it came to me that I had no choice but to now consider that.

Q. And so will you go this far that in the meeting with Mr. Saleh in July of 1984 in which the materials set out in his memorandum were discussed, that you raised the general economic downturn, the similar problems in other financial institutions, the desire that the company be given the time to get on side, and the fear that an investigation might cause a run on the company with the potential domino effect on other institutions with which you were dealing?

A. Those matters were discussed often and could have easily been discussed at that time.

More succinctly, she stated: (TR. Vol. 167, Page 31515)

Q. Did you in any way -- I put to you you did in some way communicate to Mr. Saleh, and incidentally, to Mr. Martin, that through 1984, 1985 and into 1986, Saleh was not to obtain an independent consultant because to do so would focus the attention of the public on these companies. You communicated that to him somehow; is that right?

A. Yes, very, very possible.

Osterman also appeared to concentrate her concerns, as did Martin, on the welfare of the companies, rather than the welfare of the persons who were then purchasing investment contracts, which I have pointed out earlier in my conclusions is, in my opinion, erroneous and contrary to the purpose of the ICA. In that regard, she stated: (TR. Vol. 166, Page 31110-16)

A. My verbal presentation would have been that the department considers the companies impaired. The outside auditors do not. And it is a matter that has to be resolved.

THE INSPECTOR: What steps were being taken to resolve that? I haven't heard of any yet. Were there any? I mean, you've known about this since January of '84, and this is November of '85, and what steps had been taken to determine whether the auditors or your department were right?

A. Well, Mr. Code, in terms of the real estate area, I have said as clearly as I can that I did not believe the appraisals that might be garnered to be anything but subjective and, on that basis, would not be willing to call the licences of the companies. And I believe that my senior regulators, in terms of our discussion when I challenged them to be unequivocal about this matter, they could not be.

THE INSPECTOR: The senior regulators being Mr. Saleh?

A. Mr. Saleh and Mr. Martin.

THE INSPECTOR: And Mr. Saleh has said that he wanted to get appraisals. And you said they aren't of any value, at least that's what you've said today and that's what he said you said, and not to get them. So what I'm wondering is, what steps? Was it just going to be left until you determined that the real estate had come back to some value? Is that -- I mean, just give them enough time and when real estate comes to some settling down of a value, be it two years, three years or five years, we'll then determine between the two auditors which one is right?

A. It was a matter of, I guess, a judgment call as to whether we were in a situation, which I believe we were coming to in late '85 where, in fact, we could rely upon the objectivity of appraisals. I think, Mr. Code, I could just demonstrate one area that came to me which, I suppose I put a lot of weight on. There was a federally chartered life insurance company operating in Alberta. I got word from this company that the federal government was going to literally take them down, again because the Federal

Department of Public Works, Supply and Services, I gather, were the ones that did appraisals for the Federal Department of Insurance. And as I recall, it probably was Mr. Hammond at the time. I was prevailed upon by this insurance company, senior people in it who visited my office. They said, these people are wrong, there is the odd spot in the real estate market, and what they have done is painted everything with a very broad brush, reduced significantly the valuations because it's a very subjective area at this point in time, and they are dead wrong and this company is going to be wrong --this company is going to be gone.

I phoned Barbara McDougall and asked her if she felt that they would be justified in doing this based on the situation in Alberta in the sense that appraisers were very far apart on valuations. She said she would hold off. Later on, it was not that long time past, and there was an arm's length real estate transaction which showed the appraisals to be significantly out of step with what had been put forward. And I took that and maybe an unfair extrapolation and said, we could have the same thing here. Albertans who have investments in these two companies have already suffered whatever harm there is to suffer. Government had nothing to do with the drop in the real estate market. And so the existence of the condition was there, the amount of it in terms of what the auditors were saying was obviously an area under major discussion.

THE INSPECTOR: So then I understand that, in fact, there was no attempt to resolve this, what you had decided was the policy of your department was to let the companies go on until you determined that the real estate market come back and appraisals could help? Would that be fair?

A. That's right. I wouldn't necessarily say "came back", but that the appraisals could be more reliable.

THE INSPECTOR: In the meantime, whatever the status of these companies -- well, I'm just trying to get that understanding.

A. Fair enough. It was certainly my view that to take such incredible precipitous action, which wouldn't have changed the position of those who had invested in the company at that time, to take that precipitous action, I'm sure that we could have been sitting in a scene such as this and I would be challenged about the judgment exercised had the companies' licences been pulled, and I would be asked how on earth could you do this given that there wasn't a reliable real estate market at the time.

THE INSPECTOR: Well, we'll ask what consideration went into all those people putting money into the companies during 1984 and 1985? What protection were they to get from this policy?

A. Well, at best, you could say that this was a rock and a hard place scenario. I went through it with the credit unions and when I came to the conclusion that the number of credit unions that were in dire straits could pull down the whole system, remember when we're talking about companies who have an insurance scheme, the credit unions, the trust companies, the banks have insured deposits. The people who put their money into those institutions are going to get less interest because they have to pay into an insurance fund, whether it's to CDIC, or in the case of the credit unions, whether it was the Stabilization Corporation. And when it was obvious, in the case of the credit unions, that the Stabilization Corporation would not be able to handle the holes that were there in the credit union system, I was then in a position where I could have gone out to the street as the town crier and said, they're insolvent, they're insolvent, which I'm not sure just at that point in time would have helped the depositors; or put together a package which would have been, in the longer term, best interests of all of Albertans, which was what I did.

But, Mr. Code, I did not know that my colleagues would support me in that endeavour, and so at that time I was sitting in that rock and a hard place scenario measuring, if you will, in a subjective way the individual interests against the overall public interest. And the individual interest to some degree had already been addressed by the Alberta Home Mortgage Corporation policy that we had not to dump a bunch of real estate on the market, and I saw the credit unions as another step in helping all the investors, no matter where they were.

THE INSPECTOR: But the question is, that I asked you, was what consideration was given to those people putting money into companies that your department said were offside and the real estate values were down? What protection were they to get from that investment? What was your consideration to them?

A. My consideration was the overall public good which I thought benefited them as well.

THE INSPECTOR: I don't follow that. Perhaps you could explain to me how they're putting money into these companies did something for their good?

A. They're putting their money into these companies did not necessarily, except for the interest rate that they were earning, was not necessarily, if you look down the road at eventually what happened, in their best interests. But, Mr. Code, this was the very -- I guess the position that we were in in trying to judge what was going to be best in the longer term. And I have no explanation other than that.

THE INSPECTOR: And they would then be carrying out the government policy by putting money into something that could have been taken down?

A. Yes, if you believed that, in fact, you had significant evidence to take them down.

THE INSPECTOR: Your department believed that, didn't they?

A. Yes, they did.

It is my opinion that this greater good theory was directly outside and indeed contrary to the purpose of the ICA, which is to protect those persons purchasing investment contracts from licenced companies within the Province of Alberta. It is also, in my view, based on a misapprehension as to the nature of the companies being regulated, and their relation to the remainder of financial institutions within Alberta. As I stated during my comments regarding Martin, the other institutions that this policy protected all had a form of protection or guarantee for depositors, save FIC and AIC. Those were the only deposit taking institutions in Alberta, required by legislation to be regulated like a deposit taking institution, that did not have such guarantee. This effect was not apparent to any of Saleh, Martin, or Osterman. To use the depositors' retirement savings to bolster up institutions that the government was already guaranteeing was to in effect gamble with those savings to partially benefit the government itself. As well, Osterman, in my interview with her made it clear to me that she, as well as Martin, shared the view that FIC and AIC, in her consideration, were in a grey area more like investment companies rather than deposit taking institutions. She was, however, not as clear in the dichotomy as Martin, but simply said her view of them leaned more towards that consideration. She did confirm with me that in general terms the Alberta government was less likely to provide financial support for investment companies, as opposed to deposit taking institutions.

Osterman, upon receiving a draft copy of these comments in accordance with section 27(3) of my Act, took issue with these conclusions. Her main concern is that she is of the firm and unshakeable view that she at no time prior to her change of portfolio in November of 1986 received hard facts and recommendations for action from Saleh and Martin that would have alarmed her and caused her to act. When I suggested to her that the information she did have should have caused her to be concerned enough to ask some hard questions herself, she stated that she had received appropriate and specific advice from Saleh and Martin in the past regarding problem financial institutions of a much greater magnitude than these and had acted upon that advice. She believed herself to be justified in awaiting such advice here.

As may be seen, Saleh and Martin state they did communicate the appropriate advice and recommendations but were prevented from acting by what they perceived to be policy. The answer, like most such disputes on evidence, undoubtedly lies between the two extremes. However, such a failure of meaningful communication, in discharge as an important and mandatory statutory duty to enforce the ICA, must be found to be the responsibility of all involved, including Osterman.

After June of 1986, the relevant officials involved were A. J. McPherson, Deputy Provincial Treasurer, A. H. Kalke, Assistant Deputy Provincial Treasurer, who in effect functioned as Superintendent of Insurance, and the Minister, the Provincial Treasurer, Dick Johnston.

The main allegation against officials of Treasury in the Code Investigation was that Alberta Treasury took the decision to build its own file of information, and not to rely extensively on the information obtained from CCA, although it did take over some of its personnel who had been involved in the regulation of the investment contract companies. As well, the allegation was made that they did not act as quickly as they ought to have in becoming aware of the situation and in eventually removing the licences to operate under them ICA of FIC and AIC. Regarding the matter of building their own file of information, while hindsight may dictate that a different decision could have been taken, I cannot find administrative error in making that decision, especially so in considering the indecisiveness of the officials who had been in charge, including Saleh and Martin. It is not for me to find a decision to be an administrative error if it is reasonably taken given the circumstances, and I believe that decision was.

Regarding the speed with which Treasury moved, given the limitations of operating within government, it is my opinion that they moved with remarkable speed. A good part of the reason for that is that a review of the documentation prepared and the steps taken after June of 1986 clearly shows an ability to gather information, understand it, and to succinctly recommend upon it, in both Kalke and McPherson. The Minister as well was receptive to the information that he received, appeared to understand it, and gave the appropriate directions. Certainly in his meetings with representatives of PGL, he, in my view, discharged his administrative responsibilities appropriately under the ICA. As I had indicated at the outset of this report, the fact of whether or not any form of support should have been given as part of the decision to end the operations of FIC and AIC is clearly a political decision, and is outside of my deliberations.

The only other Minister involved in the matter was Adair, who was involved as Minister of CCA from February 26, 1986, to May 25, 1986. Given the information that he was given by Martin, from Martin's testimony, I do not find his actions to have contributed to the administrative failure which took place in the regulation of FIC and AIC pursuant to the ICA.

In summary, therefore, it is my opinion from 1984 onwards, there was virtual abdication of the regulatory duties imposed on CCA regarding the operations of FIC and AIC. That abdication came about as a result of the administrative failures I have outlined above of the senior staff of the department, and the Minister. At a time when the department had abdicated its duty to regulate, it knowingly allowed FIC and AIC to go on a major selling campaign, part of which involved moving potential depositors away from a secured deposit with PS&T to unsecured deposits with FIC and AIC. The decision to abdicate responsibility was taken for the general reason that to exercise any regulatory authority against FIC and AIC would endanger the health of the entire financial industry of Alberta, and was taken with little regard for the persons who purchased investment contracts after 1984. The interests being served were those of the investment contract companies, FIC and AIC, and the interests of the Alberta regulated financial industry in general, in which government itself had a vested interest because of guarantees it had given.

It is my opinion that these reasons are outside of the purposes of the ICA, which was enacted to protect, albeit somewhat poorly, the interests of the investment contract holders and not of the companies from which they purchased investment contracts or the financial industry in general. It is my further opinion that the department's decision to put what was generally regarded by the department as the retirement savings of purchasers of investment contracts in jeopardy in order to achieve some greater good without any notice or warning to those persons, and without any form of deposit guarantee, public or private, was wrong.

In applying the tests under my Act, it is firstly my opinion that the decision to abrogate regulation under the ICA, and the negligent actions in carrying out the one duty undertaken, that is approval of applications and sales brochures of FIC and AIC by the Superintendent, may well be contrary to law, which is the test that is set out in section 20(1)(a) of the Ombudsman Act. In order to reach that conclusion, I must apply the legal test that I have outlined earlier in this report. In doing so, it is firstly my opinion that the ICA meets the tests set out by the Supreme Court of Canada in Kamloops v. Neilson as creating a sufficiently close relationship between the investment contract holders and the government regulators that those regulators should have known that their failure could contribute to the damage caused to the investment contract holders. Indeed, a review of the documentation and testimony at the Code Investigation, and my interviews, show that the regulators were completely aware of this; it is significant to note that there was awareness by all concerned that FIC and AIC used their requirement of compliance with the ICA as a major selling tool. Secondly, it is my opinion that the ICA is sufficiently different from legislation that has been found not to support such a duty, such as the Deposit Taking Companies Ordinance of Hong Kong, examined in the Yuen Kun-Yeu case.

Specifically, the ICA gives the Superintendent of Insurance the specific approval of compliance with specific Capital, Deposit and Reserve Tests under section 8; the right to conduct evaluations and enforce change in the value of assets used to meet those tests, under section 29; the right to approve the reserve rate used in calculation of some of those tests, under section 30; and the duty to accept and approve for use all brochures and contracts used by investment contract companies, under sections 24 and 25. These powers, in my view, are sufficient to support a conclusion that the ICA creates a general duty to purchasers from investment contract companies. In my opinion, there are no considerations which ought to limit or negate the scope of that general duty.

In consideration of whether the specific duties under the ICA are operational, or policy/discretionary, or indeed quasi-judicial, it is my opinion that the necessity to analyze the various powers available to the Superintendent of Insurance under the ICA to ascertain that becomes academic in light of my opinion that the Superintendent (with the concurrence of the Deputy Minister and Minister) abdicated his duty for reasons outside of the objects of the ICA, with the exception of his duty under sections 24 and 25, of approval of brochures and applications, which, in my opinion, he performed negligently.

Whether academic or not, however, in my opinion, the abdicated and failed duties may be categorized as follows:

(1) Failure to revoke registration under sections 9 and 10 of the ICA is, in my view, quasi-judicial as that matter may be appealed through the courts. A failure in that duty would only attract liability if it was done for reasons of bad faith.

(2) Failure to conduct an investigation and to report to the Minister under section 37 is, in my opinion, discretionary. The failure to do that would only attract liability if it were voluntarily undertaken and performed negligently, or the decision not to undertake such investigation was made as a result of improper considerations under the ICA or taken in bad faith.

(3) The duty to properly scrutinize and control the brochures and application used by FIC and AIC is, in my view, operational. Therefore the usual standards of negligence would apply to anything done by the Superintendent in furtherance of that duty.

It is my opinion that the decision not to undertake any of the enforcement actions available under the ICA, and specifically not to remove the licenses of FIC and AIC or to make a special report to the Minister, is a decision taken outside of the objects of the ICA, and was a decision taken in bad faith, as defined by the Supreme Court of Canada in the cases of Roncarelli v. Duplessis and Kamloops v. Neilsen. I believe the extraneous considerations of the Deputy Minister and Minister were "a clear departure from its lines or objects", (referring to the ICA,) as was set out in Roncarelli and "resulted from considerations of extraneous or improper matters or for an improper purpose" as set out in Kamloops. As well, the actions of the Superintendent in approving investment contracts and brochures containing the words "guaranteed", "safety", and "security", given the circumstances, was in my view negligent.

Applying the remainder of the tests set out in section 20 of the Ombudsman Act, in my view, the decision to abdicate enforcement by the Superintendent, and the negligent carrying out of the duties regarding brochures and application forms was:

(a) unreasonable, unjust, and improperly discriminatory to the investment contract holders under subsection 20(1)(b),

(b) was based wholly or partly on a mistake of law or fact (in that Martin testified it was always his assumption that policy could override the Superintendent's duties under the ICA, which I do not accept) contrary to subsection 20(1)(c) and,

(c) as I have stated above, was clearly wrong on a common sense basis contrary to subsection 20(1)(d).

Finally, it is my opinion that the interests of those investment contract holders who purchased or renewed investment contracts after June 30, 1984, were substantially harmed and they clearly suffered a part of their losses as a result of that improper decision.

As well, the employees of the investment contract companies may have suffered harm, although I believe that their own conduct in large part contributed to that harm as well. Evidence at the Code Investigation indicates that employees were given limited information with respect to the requirements of the ICA. Until 1986 there was no standardized training program for sales trainees.

The following gives some insight into training detail: (TR. Vol. 16. Page 2773-4)

Q. Would you train the rookies that the bank was the Royal Bank of Canada?

A. Not specifically.

Q. Would you give them a copy of the Investment Contracts Act?

A. No.

Q. Would you tell them that there were regular reporting requirements?

A. Yes.

Q. Would you tell them what qualified as assets under the Canadian and British Insurance Companies Act?

A. No.

Q. In terms of financial information about FIC and AIC, would you give them any detailed financial information?

A. No. I had none.

Q. Would they ask questions?

THE INSPECTOR: You say you had none?

A. I had none.

Q. MR. WITTMANN: Would they ask questions, sir?

A. Generally not.

It is my opinion that the employees of these companies should have been less willing to accept these explanations at face value, especially so when many of them took on the duties of advising the public.

I do not believe that the owners of the investment contract companies suffered any harm; conversely, their position was maximized at the expense of the general public of Alberta in a wrongful fashion.

I had therefore made recommendations in the next section of this report regarding compensation to the investment contract holders. However, the Government of Alberta announced an offer of compensation to investment contract holders on July 28, 1989, in the Legislature, and I will instead comment on any recommendations I may have resulting from that offer. I will not be making any recommendation for compensation to employees of FIC and AIC. I certainly will not be making any recommendation for redress for the owners of those companies.

I will also be making some general recommendations for legislative and regulatory reform which I hope will be of assistance in preventing such a situation from developing in the future.

D. RECOMMENDATIONS

(1) RECOMMENDATIONS REGARDING COMPENSATION

As the report from the Code Investigation made clear, shortfalls in regulation of FIC and AIC were a contributing factor to the failure of the companies. However, rather than a direct contributing factor, the regulatory failure was identified as a factor that could have prevented the failure or reduced the magnitude of the loss. As Mr. Code stated,

> "I am of the further view that the evidence tends to show that another significant causal factor with respect to the reasons for the financial failure of FIC and AIC, especially in the context of the timing of the failure, was the wilful refusal of the regulators to act effectively when they knew that the investment contract companies' strategy, policies and practices were not protecting the investment contract holders." (Report of Code Investigation, page 330).

It must be recognized that the other factors identified as being reasons for the failure of FIC and AIC were operational and instrumental in contributing to the losses of the investment contract holders. Those reasons, as identified by Code, are as follows:

(a) Their boards of directors lacked any degree of independence from the parent company;

(b) Their strategic direction in the late 1970's was inconsistent with the stated investment objectives to move away from dependence on mortgage loans;

> (c) Their chosen response to a changing market place resulted in significant modifications to the investment contract products (a movement to higher cost single pay and term products) which consequently forced them to seek more speculative assets that yielded higher returns;
>
> (d) Their cost and commission structure resulted in higher costs of operations than comparable institutions offering comparable products;
>
> (e) Their capital structure was inadequate and did not permit them any margin of error in managing their investment portfolio;
>
> (f) There was an inability to deal with the impact of the real estate collapse on the investment contract companies' mortgage portfolios.
> (Report of Code Investigation - Page 329-30)

As well, two other factors were identified as being contributing factors in the same manner that administrative shortfall by government is a contributing factor, as follows: (Report of Code Investigation - Page 330, items 1 and 3)

> 1. Consideration of the overriding business problems faced by FIC and AIC. Instead, they adopted an ill-conceived work out strategy which was directed at disguising the realities of the investment contract companies; financial situation through investments in related parties, changes in accounting practices, and the recording of non cash gains on transactions. There was no addressing of the overriding business problems that the companies faced.

(3) A realistic approach to qualified assets and financial statement disclosure. Instead, management of the investment contract companies were concerned with the technical interpretation of the ICA and with minimum financial statement disclosure over the substance and spirit of the ICA and GAAP.

As well, a review of the testimony of purchasers of investment contracts during the Code Investigation, and my interviews with such purchasers, also show that those persons themselves bear some responsibility. In most cases, purchasers were aware of the lack of CDIC insurance for investment contracts, and accepted assurances without further inquiry as to the safety of their investment without it. They, in most cases, were intent on maximizing their interest return without asking the necessary questions as to how those higher rates could be paid without risk. The blind assumption of the explanation that 100% of all monies invested was on deposit with a major chartered bank is evidence of some negligence on the part of purchasers; if it was, how could the banker earn (and pay to the purchaser) more interest than that bank currently offered? While the major contributor to the losses was the companies shortfalls, combined with the collapse of the real estate market in Alberta, and while a significant contributing factor was government administration shortfall, the action of the purchasers in choosing the contracts over other investments cannot be ignored.

For those reasons, it had been my intention in the preliminary draft of my report, and at the time of my circulating the selected comments from the report required to be circulated under section 27(3) of my Act, to recommend compensation based on a portion of the losses suffered by investment contract holders who had invested after June 30, 1984. As I have indicated earlier in this report, June 30, 1984, was selected by me because it is my view that the registration of FIC and AIC under the ICA should have been revoked on or about that date, given the information then available to government regulators more particularly set out in the opening pages of the conclusions section of this part of my report. It was to have been my recommendation that government accept some liability for these losses.

I am therefore pleased to see by the announcement of an offer of compensation, government has accepted a portion of the liability, by offering to compensate investors up to a level of 75 cents for every dollar claimed as of June 30, 1987. In the case of FIC, this offer will be made at 18 cents on the dollar; in the case of AIC, this offer will be made at 15 cents on the dollar.

Given all the circumstances, this offer would certainly fit within the general intent of any recommendations for compensation I had contemplated.

I would, however, make some comment concerning compensation for out-of-province investors. Given my mandate, my recommendation for compensation would have included compensation only for those purchasers of investment contracts sold within the Province of Alberta. That is so because the ICA and the duties of the Alberta regulators pursuant to the ICA, relate to the sale of investment contracts within the Province of Alberta, no matter where the purchaser resides. That immediately raises the questions about the losses of holders of investment contracts who purchased them within other regulatory jurisdictions, and specifically other provinces in Canada.

The main argument that appears to be made by officials in other jurisdictions is that they implicitly relied, and were entitled to rely, on the Province of Alberta to regulate FIC and AIC pursuant to the ICA. Such interprovincial reliance would only be enforceable if it were as a result of formal written agreement between the provinces concerned. No such agreement exists.

There is, however, a suggestion that there is a convention, or longstanding practice well known to all provinces, that reliance on the issuing jurisdiction is understood. I could not find, in my review of all of the actions of the Government of Alberta, including actions between it and any other government concerning investment contract companies, that there was any such convention or indeed any real evidence of such reliance.

For example, the Province of Ontario was never prepared to allow FIC and AIC to operate within that province. Other provinces took actions themselves over the years of regulation of FIC and AIC on a unilateral basis. For example, in 1967, AIC's registration was not renewed in the Province of Saskatchewan as a result of the presentation of a Special Report to the Minister by the Saskatchewan Superintendent of Insurance. There appeared to be no reliance on the Province of Alberta regarding such report, or regarding any later dealing with sales privileges for AIC. Secondly, in 1973, the Province of British Columbia caused AIC to abandon its registration in that province, after making it clear that the registration would not be renewed in any event. Again, there is no evidence of reliance on the Province of Alberta or its regulators regarding that matter.

As well, other jurisdictions undoubtedly have responsibility to their own citizens for the governing of the sale of investment contracts within their own provinces, which may well supersede or at least contribute to the responsibility for losses regarding those transactions over and above any default by the regulatory system in Alberta. For example, on May 29, 1984, the Superintendent of Insurance of Alberta received a letter from E. P. Jewitt, C.A. the Deputy Superintendent of Brokers for the Province of British Columbia, indicating that he had just discovered that although FIC and AIC were required to file quarterly statements with his department under section 17 of the Investment Contracts Act of British Columbia, the last such quarterly statements received for those companies was for the quarter ended December 30, 1978. He had written the letter because he was concerned about shortfalls in the year-end statement of the company for December 31, 1983.

As well, it is clear that the registrations for FIC and AIC were not renewed on April 1, 1986, in the Province of British Columbia. They were requested to discontinue selling voluntarily until the problems regarding that renewal were resolved, but that, from the evidence at the Code Investigation, did not take place. FIC and AIC were re-registered on August 27, 1986, in the Province of British Columbia, after the officials there had conducted an independent review of the affairs of the company and had caused a capital injection of $1.683 million in AIC and $9.567 million in FIC.

Having said that, however, in dealing with administrative shortfall only, there was clearly no question but that the failure to enforce the provisions of the ICA against FIC and AIC in the Province of Alberta in any way after June 30, 1984 may well have contributed to the losses suffered by purchasers of investment contracts in other provinces. As a result, it was to be my recommendation regarding compensation that the Province of Alberta conduct negotiations with the governments of the other provinces involved, with a view to negotiating a joint plan of compensation, with responsibility to be shared between the Province of Alberta and the jurisdiction in which an investment contract was sold after June 30, 1984. Such responsibility was to be determined in accordance with the considerations of reliance upon regulators in the Province of Alberta and considerations of the province in which the investment contracts were sold being able to demonstrate some form of responsible regulation of sales within that province. The offer that the Government of Alberta has made of course includes the same offer to investors no matter where they resided, although I now understand that in exchange for acceptance they will be required to assign any funds later received from other governments to the Province of Alberta.

(2) RECOMMENDATIONS FOR IMPROVEMENT IN REGULATORY PRACTICE AND PROCEDURES

Much has been made throughout my investigation and the Code Investigation about the admitted deficiencies of the ICA. They have clearly been identified, and it is also clear that timely statutory amendment would have made it easier to regulate FIC and AIC than it was. However, the failure here was not that of the statute; it was that the decision had been taken not to regulate at all for a purpose unrelated to the ICA and to the protection of the purchasers of investment contracts. The regulatory system, meaning the monitoring of FIC and AIC, primarily by the auditors, worked effectively. The decision-making component of regulation did not. All decisions were to be made, ultimately, by the Minister, who had the least detail and grasp, of the senior people involved. The decisions that were made by the Superintendent of Insurance, primarily relating to advertising brochures and contract wording, were made indecisively and negligently. Unfortunately, in examining the actions of government generally, as I do, I see that lack of effectiveness in particular departments, but in other departments appropriate decisions are taken or strongly recommended, and the duties of the department are carried out effectively and on a timely basis.

Is there any remedy, and, if so, what is it? In my view, a number of things might be considered.

One of the problems identified is that, in government, ministers change frequently and deputies almost as frequently, for reasons not always associated with their ability as administrators. Osbaldeston's study, for example, identified the fact that at the federal government level, the life of a Minister/Deputy team is seldom longer than two years and in the period 1984-87 averaged one year. The experience and history of the regulation of FIC and AIC bears that out. Studies such as Osbaldeston's provide recommendations that may be meaningful in assisting, in general terms, prevention of the shortfalls identified. I would like to adopt as part of my recommendations in this section of my report some of the recommendations from Osbaldeston's study, as follows: (Note:

Because his study deals with federal government, I have amended the recommendations to insert references to provincial government)

1. ACCOUNTABILITY SYSTEM: The federal (provincial) government should reaffirm and reinforce the accountability of deputy ministers to ministers and in the future, changes by governments or Parliament (the Legislature) should not be allowed to jeopardize this critical accountability relationship.

2. MINISTER-DEPUTY MINISTER WORKING RELATIONSHIP: The federal (provincial) government must place a higher priority on the establishment of strong working relationships between ministers and deputy ministers and should establish an objective of two years as the minimum time that ministers and deputy ministers should work together.

3. MINISTERS OF STATE: The federal (provincial) government should ensure that the responsibilities of ministers of state are clear and that their relationship to ministers and deputy ministers is understood.

4. CHIEF POLITICAL AIDES: The Prime Minister's (Premier's) Office should establish a selection, training and development program to ensure the Government has well qualified chief political aides.

5. Omitted as not applicable to provincial government.

6. DEPARTMENTAL KNOWLEDGE OF DEPUTY MINISTERS: The federal (provincial) government should:

(a) place a higher priority on the appointment of deputy ministers who are knowledgeable about a department's policies, programs or field of activity and its management requirements; and

(b) establish a target of three years as the minimum tenure of a deputy minister in a department.

7. EXPERIENCE OF DEPUTY MINISTERS: The Government should increase the overall level of experience of deputy ministers as deputy ministers to an average of four years (from its present level of about two years) and should make a special effort to retain several senior and successful deputy ministers who can provide continuity, expertise and advice to ministers.

8. CAREER AND SUCCESSION PLANNING: The Government should develop a career planning and selection system for existing and prospective deputy ministers that trains them to assume responsibility for particular departments and central agency positions.

9. Omitted as not applicable to provincial government.

10. PERFORMANCE APPRAISAL: Deputy ministers should be given more complete feedback on their performance. The Secretary to the Cabinet, through the Associate Secretary to the Cabinet for senior personnel, should discuss with each deputy minister his or her performance on an annual basis in relation to agreed upon priorities. (This recommendation should be modified to suit provincial Cabinet management).

In further recommendations particular to the situation here, I think it is important that the Premier, and senior Cabinet advisers, ensure that ministers, especially new ministers, understand the difference between departmental programs and practices that may be modified, enlarged, or even abrogated based on policy from time to time, and regulatory duties with which a department is statutorily charged and which must be performed. It is trite, but it must be made clear that legally and morally, even a minister of the Crown must follow the laws governing the operation of his or her department. As well, ministers must insist that the personnel within their department carry out their duties, and must allow them the freedom to do so. That includes managing the department in such a way that it does not leave departmental officials in fear of taking action at all for fear of reprisals; rather the minister must communicate that he or she is prepared to back the department if a difficult decision, properly made, becomes politically problematic. In this case, the department waited in vain for the minister to advise them to act, but did not, in my view, provide the necessary impetus and input to cause that decision to be considered properly by the minister. A former minister who had charge of regulation of FIC and AIC, in my interview with him, expressed the proper position, in my view. He said it was his duty to allow and encourage the regulators to regulate; it was his political duty to oversee and advise the regulators to ensure that they did not act over-zealously, to the detriment of the objectives of the department. However, it was clear that the recommendation to act, and the reasons for reaching such a decision, had to come from departmental officials and not the minister.

I am hopeful that these recommendations will be considered by both the Cabinet and senior officials, and at least discussed openly among them in the context of improvement so that situations of this disastrous effect do not occur again.

(3) RECOMMENDATIONS FOR LEGISLATIVE REFORM

There are two major problems that both my investigation and the Code Investigation have identified regarding the sale of investment contracts in Alberta. Those are firstly the confusion in the minds of the public of investment contracts with guaranteed deposits offered by chartered banks and trust companies; secondly, the lack of protection for purchasers by reason of poor capital and regulation of investment contract companies, which is not offset by any requirement of disclosure of those risks to purchasers, as would be required under securities legislation. It is, in my view, those two problems that have led to the many dubious practices FIC and AIC indulged in, which are described in my report and in more detail by the report of the Code Investigation.

In this section, dealing with legislative reform, it must be remembered that my office is not a law reform commission and does not possess the resources of one. The best I can offer are general recommendations which I hope will act as a catalyst to further the legislative process. It must as well be remembered that a strong financial industry is necessary, and therefore rules and regulations must be practical in order to allow that industry to develop and compete. Therefore, any suggestions made by me should be considered by government in the usual fashion, in consultation with all groups concerned, including industry.

Firstly, regarding the narrow issue of the ICA, I am pleased that government has decided that the ICA be repealed immediately. That legislation is not suitable in any way to the regulation of sales of financial instruments like single pay investment contracts. Those contracts, as far as the purchaser is concerned, are sold as being indistinguishable from term deposits offered by chartered banks, and guaranteed investment certificates offered by trust companies. They should offer indistinguishable protection. It is therefore my recommendation that single pay investment contracts should not be sold unless they are subject to proper deposit taking institution protection such as is provided by the Trust Companies Act of Alberta, which includes a borrowing to capital ratio, appropriate controls on the investment of the funds received and CDIC insurance coverage.

Unfortunately, this recommendation may be thought to be unfair to the remaining seller of investment contracts in Alberta, Investors Syndicate Ltd. This is especially so because that company, whose regulatory history with the Government of Alberta I reviewed in detail over many years as a counter point to the regulatory history of FIC and AIC, has always operated in accordance with the ICA and the requirements of the Alberta regulators.

I met with representatives of that company during my investigation, at their head offices in Winnipeg, to discuss these matters. Unfortunately, consideration must be given to the regulatory regime in general and not to one company in particular. Investors Syndicate Ltd. markets its investment contracts on the same basis as did FIC and AIC; that is, it markets single pay investment contracts in competition with banks and trust companies, and in doing so features the safety and guaranteed nature of such contracts. Appropriate legislation must be in place to back up those claims and to require appropriate corporate practices to achieve them. The argument that investment contracts are different than bank term deposits and trust company guaranteed investment certificates, and are more akin to life insurance contracts, and therefore do not require a specific and high level of regulation, does not, in my view, withstand logical analysis.

An interim solution, adopted in British Columbia as a result of the Report to the Minister of Finance and Corporate Relations by Lyman Robinson, Q.C., which report commented on the business practices of the Principal Group of Companies, suggested that the regulation of investment contract companies be placed under the Securities Act. That automatically, in Alberta, results from the repeal of the ICA, because investment contracts are clearly within the definition of a security in the Alberta Securities Act. Other provinces are following that example. The management of Investors Syndicate Ltd. also stated to me that they were able to operate in that environment.

In the short term, such a change will at least provide enforced disclosure to the purchasers of investment contracts of the risks involved. However, I do not believe that single pay investment contracts, which are clearly not an investment but are a deposit, should be regulated by the Securities Act in the longer term. The nature of securities regulation, for the most part, is that some equity is purchased in the investment, and as a result either some control in the company being purchased, or some preferential right to part of its assets on dissolution, is granted. A debtor-creditor relationship, which an investment contract is, with large borrowings from the public but in small individual amounts, should not, in my view, be acceptable unless it carries safeguards with it. These safeguards should limit the ongoing operations of the debtor company accepting deposits, including the minimum requirements of a proper capital to borrowing ratio and limitations on investment of the funds.

For the reasons set out above, I believe all deposit taking companies should be dealt with under generic legislation, creating an equal set of rules for all companies competing for deposits.

The larger question is what can be done about the specific abuses that were endemic to the operation of the Principal Group of Companies, including FIC and AIC and PGL sales of promissory notes, to prevent those from happening in the future. These abuses are clearly set out in the section "Money In" at pages 31-80 of the report of the Code Investigation. These techniques are probably not exclusive to the Principal Group but represent the result of the movement to the "one-stop shopping" concept of the offering of a number of competing financial products by an integrated group of financial institutions. As well, there is the problem that many institutions now hold out sales people or persons who receive commission from them for recommending their products as supposedly sophisticated and impliedly independent financial planners. Fortunately, the Government of Alberta is already, in my view, aware of this problem and is beginning a process to deal with it. Some of the more important steps taken to the present date are as follows:

(a) The establishment in March of 1987 of the Ministerial Advisory Committee on Fair Dealing in Consumer Savings and Investments (Cashion Committee) to review draft insider trading and self dealing amendments to the Securities Act and examine consumer needs in the financial market place. As part of my investigation I met with Mr. Cashion and received valuable assistance.

(b) Establishment of two successive agreements for information sharing by provincial ministers responsible for financial institutions.

(c) The report of the Ministerial Advisory Committee, entitled "Blueprint for Fairness".

(d) As a result of recommendations in that report, the establishment of the Industry Consumer Task Force on Consumer Education in March of 1989, and a further committee known as the Industry Consumer Advisory Committee on Financial Planning.

(e) Introduction of amendments to the Securities Act in the current sitting of the Legislature.

(f) Tabling of a White Paper representing a Financial Consumers Act in the Legislature during the current sitting. I note by a review of Hansard that all parties in the Legislature have approved these general initiatives.

It is my opinion that the timely implementation of the matters raised in the White Paper would go a long way to resolving many of the problems identified by the Code Investigation and mine, and I recommend that the process continue with all possible speed.

Finally, because I have recommended that regulations similar to that dealing with provincial trust companies govern the marketing of investment contracts in the province, I would not want that to be taken to mean that I am satisfied as to the current adequacy of such legislation.

In that regard, legislation dealing with financial institutions has been the subject of much study over the past several years, mainly as a result of the failure of the Northland Bank and Canadian Commercial Bank, and several large and regional trust companies. Some of the studies which I have reviewed include the 1986 report "Towards a More Competitive Financial Environment" which is the 16th report of the Standing Senate Committee on Banking, Trade, and Commerce, the 1985 report "The Regulation of Canadian Financial Institutions; Proposals for Discussion" of the Working Committee on the Canada Deposit Insurance Corporation (The Wyman Report), and the 1984 "Interim Report of the Ontario Task Force on Financial Institutions" (The Dupree Report).

These reports in general terms deal with legislation governing financial institutions and specifically deal with situations such as conflict of interest and self dealing (meaning dealing at non-arm's length with other companies owned or controlled by the same entities as the financial institution) which are clearly part of the problem that was encountered within Principal Group. As well, most of these reports suggest better control of investment practices and better capitalization requirements. As a result, a number of provinces and the federal government have presented proposals for legislative reform.

Here in Alberta, the report of the Committee on Fair Dealing dealt with a number of those matters. Alberta Treasury has prepared and circulated privately to selected recipients, in anticipation of wider circulation, a position paper and draft legislation entitled the "Alberta Loan and Trust Corporations Act" which deals with the same concerns. It is my opinion that these initiatives indicate recognition of the problems, and I recommend that the circulation of these proposals and their subsequent enactment take place with all possible speed.

6. PRINCIPAL GROUP LTD.

A. COMPANIES RAISING FUNDS IN EXEMPT CAPITAL MARKETS

A large number of the complaints that have been made to me are from purchasers of Principal Group Ltd. (PGL) promissory notes. They allege that PGL was improperly regulated by provincial government authorities in that it was allowed to raise, by July 17, 1987, when the practice was ended, approximately $86,500,000 from members of the public in Alberta and elsewhere by the issuance of unsecured promissory notes without any regulation of those sales. Approximately one third of that amount was raised in very large denominations from several of the Hutterite Colonies in Alberta.

(1) RELEVANT LEGISLATION AND REGULATIONS

The relevant legislation to my consideration of the actions of the Alberta regulators is the Alberta Securities Act and the regulations passed to implement that Act, with particular consideration being given to the exemption from the application of that legislation that was used by PGL to sell the notes without regulation.

All of the promissory notes were sold to investors pursuant to exemptions from prospectus and registration requirements of the applicable provincial securities legislation. Therefore, the investors purchased the promissory notes without the benefit of advice of salespersons registered under the applicable securities legislation and without the benefit of extensive and monitored disclosure of the business and affairs of PGL. The promissory notes sold by PGL were unsecured and were not covered by any form of deposit insurance, with the result that the investors in the promissory notes suffered substantial losses upon the insolvency of PGL and its affiliated companies.

Two types of notes were marketed by PGL:

(a) Short Term Notes: Unsecured negotiable promissory notes maturing not more than one year from the date of issue;

(b) Medium Term Notes: Unsecured negotiable promissory notes maturing more than one year but not more than five years from the date of issue.

The reason for the two types of notes is that the Short Term Notes qualified for a statutory exemption from registration and prospectus requirements that is substantially different from the exemption available for the Medium Term Notes, even though the only difference between the two types of notes is their maturity date.

Prior to reviewing the exemptions used by PGL, one must keep in mind the object of securities legislation. The main object of securities legislation is the protection of the investing public.

Although securities legislation has expanded to regulate most aspects of the trading of securities including secondary markets (meaning the trading in shares or other securities after they were issued by a company, on a stock exchange or elsewhere), traditionally securities legislation in Canada attempts to protect the investing public by requiring the registration of persons engaged in the selling of securities, and by requiring a Prospectus containing full, true and plain disclosure be distributed to investors at the time of a primary distribution of securities.

Those usual requirements for the sale of securities are more particularly described as follows:

(a) Registration: Section 54(1) of the Alberta Act prohibits a person or company from trading in a security unless that person or company is registered with the ASC. The two main reasons for the registration requirements are:

(i) to ensure that persons selling securities to the public possess a minimum qualification and level of competence;

(ii) to ensure that persons selling securities to the public are honest and of good repute.

(b) Prospectus: Section 81(1) of the Alberta Act prohibits a person or company from selling a security unless a Prospectus has been filed with the ASC and it has been approved by the Commission and the Prospectus has been given to the purchaser. The reasons most commonly given for the Prospectus requirement are:

(i) to provide an investor at the time of a primary offering a Prospectus containing full, true and plain disclosure of the business and affairs of the issuer of the security so that the investor may make a reasoned judgment as to whether he should purchase the security;

(ii) to provide statutory rights of action to investors against the issuer and other parties if the Prospectus contains a misrepresentation;

(iii) to provide a regulatory authority (the ASC) with the discretion to refuse to issue a receipt for a Prospectus if it is not in the public interest to do so.

The exemptions from these usual requirements are more particularly described as follows:-

a) Short Term Notes - Negotiable Instruments Exemption

The exemption from Prospectus requirements for the Short Term Notes is provided by a combination of section 115(1)(a) and section 66(d) of the Alberta Act. The exemption from registration requirements is provided by section 66(d). I have referred to this exemption as the "negotiable instruments" exemption. A promissory note is a specific type of security legally referred to as a negotiable instrument.

Section 115(1)(a) states:

> "Section 81 and 97 do not apply to a distribution of securities referred to in section 66, except for those referred to in clauses (1) and (n) of that section."

Section 66(d) states:

> "Subject to the regulations, registration is not required to trade in the following securities:
>
> negotiable promissory notes or commercial paper maturing not more than one year from the date of issue, if each note or commercial paper traded to an individual has a denomination or principal amount of not less than $50,000.00."

The three key requirements for the negotiable instruments exemption are:

(i) the promissory note must be negotiable;

(ii) the promissory note or commercial paper must be repayable not more than one year from the date it is purchased;

(iii) if the promissory note is sold to an individual, the promissory note must be for an amount of not less than $50,000.00.

The Act does not define negotiable promissory notes.

There is no requirement that an issuer using this exemption provide to the investor any information about its business and affairs. If information about the business and affairs of the issuer is provided, it need not be in any particular form and it need not be filed with the ASC. Further, there is no requirement to file any notices or information with the ASC setting out the details of the sale of these promissory notes.

The negotiable instruments exemptions in the Securities Act (Ontario) and the Securities Act (British Columbia) are similar to this exemption in the Alberta Act. Equivalent exemptions in Saskatchewan, Nova Scotia, Newfoundland and Prince Edward Island exist, but differ because they have no minimum purchase price and prohibit sales to individuals.

b) Medium Term Notes - Acquisition Cost Exemption

The exemption from Prospectus requirements for the Medium Term Notes is provided by section 107(1)(d), while the exemption from registration requirements is provided by section 65(1)(e) of the Alberta Act. I have referred to this exemption as the "acquisition cost" exemption.

Section 107(1)(d) states:

> "Subject to the regulations, section 81 and 97 do not apply to a distribution where:
>
> the purchaser purchases as principal and the trade is in a security which has an aggregate acquisition cost to the purchaser of not less than $97,000.00"

Section 65(1)(e) states:

> "Subject to the regulations, registration is not required in respect of the following trades:
>
> (e) a trade if:
>
> (i) the purchaser purchases as a principal and;
>
> (ii) it is in a security which has an aggregate acquisition cost to the purchaser of not less than $97,000.00."

The two key requirements for the acquisition cost exemption are:

(i) the investor must purchase the security for himself and not on behalf of someone else or in co-operation with a group of people;

(ii) the security must have a cost to the investor of at least $97,000.00.

It must be emphasized that this exemption applies to the sale of any security, not just a promissory note or other commercial paper. It would apply to the purchase of common or preferred shares, bonds, limited partnership units, or any other type of security.

No information on the business and affairs of the issuer is required to be provided to the investor. However, if a document that describes the business and affairs of the issuer is prepared for delivery to prospective purchasers and the issuer is relying on the acquisition cost exemption, sections

1(m.2) and 108.1 of the Alberta Act and section 127 of the Alberta Regulations require that an Offering Memorandum be completed in accordance with Form 43 and filed with the ASC. Section 125 of the Alberta Regulations requires the Offering Memorandum be delivered to prospective purchasers not less than two days prior to entering into a contract for the purchase and sale of securities. The Offering Memorandum provisions are also triggered if the issuer is relying on the acquisition cost exemption and advertises in any printed media or on radio or television.

The Offering Memorandum requirement has recently been changed to require very substantial disclosure, similar to the requirements of a Prospectus disclosing all financial information for a regularly marketed security. In the past, and during the relevant time I am investigating, Offering Memorandum requirements were much simpler, but did have to include the right of the purchaser to bring action if there was a misrepresentation in the Offering Memorandum.

Section 108(1) of the Act requires the vendor of the exempt securities to file with the ASC a report of the trade within 10 days of the date of the trade. Section 129 of the regulations requires that a Form 20 be completed and filed in duplicate with the ASC, and section 130 of the regulations requires that Form 20A be filed with the ASC within 10 days from the date of the trade. The Forms 20 and 20A provide the ASC with information on the names and addresses of both the issuer and purchaser, the exemptions relied on, the amount of capital raised under the exemption, and the proposed use of proceeds.

The current acquisition cost exemption in the Securities Act (Ontario) is similar to the one in the Alberta Act except that the minimum purchase price must be $150,000.00, and there is no prescribed form for an Offering Memorandum other than it must contain certain statutory rights of action for the purchaser for misrepresentations. The British Columbia equivalent exemption is almost identical to the one contained in the Alberta Act.

The Ontario exemption, formerly at $97,000.00, was raised to $150,000.00 recently.

The theory behind the exemptions is that there are trades in certain securities and trades by certain investors where the protection provided to investors by dealing with registered salespersons and through prospectus disclosure is unnecessary. The registration and prospectus requirements of the Act offer protection to the investing public only in circumstances where protection is necessary or where the investor has a "need to know".

The history of the development of those exemptions is as follows:

(a) Negotiable Instruments Exemption

The exemption for negotiable promissory notes or commercial paper maturing not more than a year from the date of issue first appeared in Ontario in the Security Frauds Prevention Act, 1928 S.O. 1928 c. 34 section 3(3)(j). This exemption was copied in Alberta by the Security Frauds Prevention Act, 1929 S.A. 1929 c. 10 section 3(3)(j). This exemption was continued in the later Securities Acts of both Ontario and Alberta, and except for amendments in the 1960's caused by the abuse of this exemption in Ontario by Prudential Finance Corp. Limited, the exemption has remained virtually unchanged in the current Securities Act of both Ontario and Alberta.

The origin and reason for the negotiable instrument exemption has not been the subject of much academic discussion. One author simply states that all Securities Acts, including those of the United States, exempt negotiable instruments and that short term negotiable instruments are not properly within the purview of a Securities Act. Another author states that the exemption is for large commercial corporations that raise capital from the public by issuing short term promissory notes or other commercial paper, which comprises what is referred to as the "money market". The exemption is granted on the basis that the investors are thought not to need protection of a registrant or Prospectus disclosure because investors in money market securities are generally sophisticated and can fend for themselves. It would appear that the negotiable instrument exemption is provided on the basis that participants in the money market are normally large commercial corporations with substantial assets and investors in the money market are normally large institutions and possess a high degree of sophistication, so that the usual protection is not required.

As noted above, the amendments to this exemption were caused by the collapse of the Prudential Finance Corp. Limited. Apparently, Prudential Finance Corp. Limited was using this exemption to sell high-risk promissory notes to unsophisticated individuals. Ontario amended the Securities Act by An Act to Amend the Securities Act S.O. 1962-63 c. 131, which provided that each such note or commercial paper traded to an individual must have a denomination or principal amount of not less than $50,000.00. The philosophy underlying the $50,000.00 figure would appear to be similar to the philosophy underlying the $97,000.00 figure discussed in the acquisition cost exemption below, which is that an individual with $50,000.00 to invest in promissory notes or commercial paper must have some degree of sophistication. However, the difference between the $97,000.00 and the $50,000.00 figure is difficult to explain.

Alberta did not immediately follow the Ontario lead in this regard. An Act to Amend the Securities Act S.A. 1964, c. 83, provided that the exemption did not apply if the negotiable promissory notes or commercial paper were sold to individuals (this is similar to the equivalent exemption in Saskatchewan, Nova Scotia, Newfoundland and Prince Edward Island). In other words, Alberta, for a time, and Saskatchewan, Nova Scotia, Newfoundland, and Prince Edward Island, required full securities regulation for promissory note sales to individuals, and only exempted those provisions for sales to corporations. However, the Alberta exemption was amended to conform to the Ontario exemption by the introduction of The Securities Act 1967, S.A. 1967, c. 76.

b) The Acquisition Cost Exemption

The acquisition cost exemption was first introduced in Ontario by the Securities Act S.O. 1966, c. 142. This exemption was introduced in Alberta by the Securities Act S.A. 1967, c. 76. The exemption introduced by these Acts is virtually identical to its current form, except that the original Alberta and Ontario exemptions were not available for sales to individuals but only to corporations. The rationale behind this exemption is that an investor with $97,000.00 to invest likely has the sophistication to fend for himself and does not need the protection of the Act. There does not appear to be any particular reason why the figure of $97,000.00 was chosen, and as noted in the negotiable instrument exemption, a figure of $50,000.00 was used to determine the sophistication of the investor. The Securities Act (Ontario) has been amended to increase the minimum purchase price from $97,000.00 to $150,000.00. However, the Alberta and British Columbia exemptions still remain at $97,000.00.

The Securities Act, Statutes of Ontario 1978, c. 47, and the Securities Act, Statutes of Alberta 1981, S-6.1, revised the acquisition cost exemption to its present form, which allows sales of these exempt securities to be made to individuals, as well as corporations. The rationale for including individuals in this exemption is that a simple business association is not a guarantee of sophistication of the purchaser and that it is futile to distinguish between corporations and individuals since an individual could simply qualify for the exemption by incorporating a company.

(2) DESCRIPTION OF REGULATORY METHODS

All matters regarding regulation of the sale of securities within the Province of Alberta are within the jurisdiction of the ASC. The members and Chairman of the Commission are appointed by the Lieutenant Governor in Council. The Chairman serves full time and is ultimately responsible for all work of the Commission. The remaining members serve as necessary to carry out their duties. Most formal decisions of the Commission can be appealed to the Alberta Court of Appeal. The Commission maintains a staff to carry out all of the duties granted to the Commission under the Securities Act, and at all relevant times (recently some change has been made) the Commission staff ultimately reported to the Chairman.

While the administration of the Securities Act is assigned to a particular Minister, which, during most of the time relevant to my investigation, was the minister for CCA, the main function of the ministry is to provide administrative service and support for the ASC, such as financial management, personnel matters, and office space. The Minister has virtually no power to control or direct the activities of the ASC under the Act.

It is important to keep in mind that the legislative purpose leading to the creation of the ASC is to provide regulation through a body independent of the administrative and political sectors of government. The financial marketplace may then be independently governed and regulated in accordance with the statute and a level, competitive, economic environment is provided without outside interference.

For that reason, there was no integration of information or support services between other departments of CCA and the ASC. Any information sharing would take place as a result of a request from other divisions of CCA, or from one of the divisions of the ASC, and was normally handled through liaison between the Chairman and the Deputy Minister.

Because exempt markets are intended by the Legislature to be free of regulation, the ASC developed no formal methods of regulating that market. There were no formal methods or procedures developed to monitor the use of the exemptions allowing the sale of promissory notes, although enforcement staff were generally aware on an informal basis of the forms filed with the ASC disclosing the amounts of, and the purchasers of, promissory notes. The exemptions allowing the sale of promissory notes are available to any member of the public, whether a person or a corporation, unless those exemptions are specifically revoked with regard to an issuer or seller of those exempt securities. In order to do that, a hearing must be held by the ASC under section 166 of the Securities Act. Evidence would be taken, parties or their counsel would be given the opportunity to make representation, and the ASC would then have to decide whether, on finding clear and convincing evidence that it was in the interest of the investing public to do so, that some, or all of, the exemptions from regulation under the Securities Act should be withdrawn regarding a particular person or corporation. This right to withdraw exemption under the Securities Act is general, and may relate to any one or all of the many exemptions under that Act. It is not designed to relate specifically to the exemptions that I have under consideration. There are no other provisions in the Securities Act or regulations which would allow the ASC to monitor or control the sale of promissory notes, other than the removal of the exemptions.

(B) PRINCIPAL GROUP LTD. AND ITS PREDECESSORS

A brief reference was made at page 319 to the development of the Hutterian Brethren Trust and PGL promissory notes. A detailed review is now included here.

The original involvement of companies in the Principal Group with sale of promissory notes appears to have evolved from the lengthy association of the Group with the Hutterite Colonies in Alberta. That association began with the acquisition of AIC in 1962. Although that company was acquired from Equitable Investments of Columbus, Ohio, it had been acquired by that company from its founder, H. Curlett, of Edmonton, Alberta, who had founded it in 1948. A great deal of the growth of AIC had been as a result of the sale of investment contracts to many of the Hutterite Colonies in Alberta. That business association was continued and expanded upon after the acquisition of AIC by the Principal Group.

This business connection was formalized on July 28, 1966, by the creation of a Trust called the Hutterian Brethren Investment Trust, which designated PS&T as Trustee to invest money on behalf of a number of Hutterite Colonies in Alberta. Investments in units of $1,000, subject to a minimum subscription of 10 units or $10,000, were solicited from those colonies. By the terms of the Trust Deed, meaning the contract between the beneficiaries (the Colonies) and the Trustee, PS&T was required to invest two thirds of the trust funds in preferred shares of Collective Securities Ltd. ("CSL") or any controlled subsidiary of it, and one third of the trust funds in Guaranteed Investment Certificates issued by FIC and AIC.

At March 6, 1967, the trust held $3.6 million in Hutterite funds, $2.6 million of which was invested in 7% first preferred shares of PGL and $1 million of which was invested in 6% and 6 1/2% investment certificates of FIC and AIC. At that time CSL was owned beneficially by Donald Cormie and some minor investors, and in turn CSL owned and controlled PGL, which in turn owned and controlled PS&T, (the trustee making the investments) and FIC and AIC.

This state of affairs highly concerned T. E. Dansereau, the Director of Trust Companies, who felt that it might contravene the Trustee Act. Dansereau's concerns were that the locking in of the Hutterian trust funds at low rates of interest, for lengthy periods of time, without any control of the operations of those companies was improper. He also felt it was improper for the trust to be charged acquisition fees and administration fees by PS&T for the benefit of providing cheap capital to its related companies. It was clearly his understanding at the time that the Colonies themselves were not making a complaint and were seemingly not prepared to take any action to improve their position under the trust.

Dansereau sought the approval of E. C. Manning, the Premier and Attorney General of Alberta, to obtain a legal opinion from C. W. Clement, Q.C., of Clement, Parlee and Company, of Edmonton, Alberta. That opinion, when obtained in 1968, stated that because the Trust Deed required these investments to be made in this way that the arrangement was legal. Dansereau remained concerned, and in 1970 obtained an opinion through the Attorney General's Department, that because of certain amendments to the Trustee Act in 1966, the actions of PS&T in investing the Hutterian Trust monies now contravened the Act. Dansereau continually pressed the Principal Group to amend the terms of the Trust Deed to meet his concerns with the treatment of the Hutterites, through lengthy correspondence and meetings with J.E. Hart, Q.C., PGL Assistant Legal Counsel. Although PS&T contested the validity of that opinion, on September 21, 1971, Dansereau, after several meetings with company officials wrote to Hart and demanded the amendment of the terms of the Trust Deed, failing which he proposed to recommend to the Minister action be taken under the Trust Companies Act to disallow the activities of PS&T in administering the Trust. Dansereau also was instrumental in having an investigator from the ASC meet with one of the Hutterite Colonies to advise them to seek independent legal counsel regarding the terms of the Trust.

After some further discussion, 75% of the preferred shares of PGL (and by now FIC) held by the Trust were redeemed by PGL in exchange for it issuing a promissory note in the amount of the value of those shares, $826,300. This is the first use of a PGL note as an investment which came to the attention of the Director of Trust Companies.

In 1973 the Trust Deed was further amended to allow for the remainder of the preferred shares to be redeemed, and required the resulting note be repaid in equal instalments of principal and interest. By 1973, the assets of the trust consisted of an 8 1/2% PGL promissory note due in 1980 in the approximate amount of $3 million, requiring repayment in monthly instalments of principal and interest, and FIC Investment Certificates in the approximate amount of $1,600,000. All investment by the trust in any company within the Principal Group, by purchasing preferred shares, had been ended.

Dansereau remained concerned throughout his tenure as Director of Trust Companies about the Hutterian Brethren Trust, as he believed its real purpose was to raise capital for the Principal Group at the expense of the beneficiaries, the Colonies, in an attempt to defeat the capital raising provisions of the Securities Act. No action, however was recommended or taken other than a continuing concern about the capitalization and operation of PS&T, to meet certain directions. PS&T, over that time, did continue to meet the directions and requirements of the Director of Trust Companies, and in fact improved its performance in meeting those requirements.

The trust continued in existence, and by 1982 the large single note by PGL, secured by its preferred shares, and given in exchange for the purchase of those shares, had been repaid in full. After that repayment, the assets of the trust included unsecured PGL promissory notes, PS&T Guaranteed Investment Certificates, FIC Investment Certificates, and some Government Bonds and mortgages. The company advised the Director of Trust Companies that the trust was in the process of being wound-down. During the winding-down, PGL purchased some of the trust assets and issued further promissory notes in exchange for them. It was during this period of time, as well, that PGL began to actively market its notes directly to investors, many of them Hutterite Colonies.

All of those note sale transactions appear to have been duly reported to the ASC, using the appropriate forms. For example, the December 1981 Report of Private Placement issued by the Securities Commission showed note sales totalling some $840,000, all of them having been made to the Kings Lake Hutterite Brethren. No Offering Memorandum describing the affairs of PGL was ever voluntarily filed with the Securities Commission. No printed media or radio or television advertisements ever came to the notice of the ASC regarding sales of notes. However, some persons purchased notes after being attracted by advertisements about guaranteed investment certificates offered by PS&T and investment contracts offered by FIC and AIC.

The first evidence of any independent consideration of the sale of promissory notes of PGL by the ASC, apart from the regular filing of the required reports of such sales and the issuance of weekly summaries of such reports by the ASC came in 1985. At that time, as a result of a rumour that a company within the Principal Group had been denied the right to purchase an Ontario Trust Company, and with the knowledge of the substantial sales of notes by PGL in the exempt market, A.T.M. Woo, Deputy Director, Enforcement, who was in charge of the Enforcement Section of the ASC, caused some informal inquiries to be made by Tom Bertling, the Consumer Relations Officer of the ASC. Bertling reported to Woo on June 6, 1985, stating that one of the companies within the Principal Group had applied to purchase a dormant trust company in Ontario, and had failed to provide further information about the application after specific information about the capital raising methods of PGL and its corporate structure were sought by the Registrar of Ontario Loan and Trust Companies. Bertling further reported to Woo that he had analyzed the Form 20 filings regarding sales of promissory notes by PGL from February 1, 1982 to 1985, and found that there were 115 filing reports representing sales totalling $45 million; 94 filings totalling $30 million represented sales to Hutterite Colonies. Only 5 filings related to sales of notes of more than $50,000 but less than

$97,000 in denomination. Many of the filings represented renewals of previously sold notes.

Woo, when interviewed by myself, stated that in examining such information, he primarily looked for a violation of the Act, such as syndication of the purchase of notes to more than one purchaser. He stated that he took comfort from the fact that the transactions were so large, because the exemption was there for purchasers with deemed sophistication and he felt that purchasers in such large amounts could be taken to have the ability to look after their own affairs. He concluded his investigation in a memo to Bertling which read, in part, as follows:

> "With respect to the private placement exemption use, I cannot identify any abuse of same notwithstanding the extensive use thereof. I note that prior to the current Securities Act coming into force, Principal Group had been engaged in private placements under the old Securities Act section 19(3). It appears that Principal is following a true and tried formula in respect of existing clients and undoubtedly with respect to new clients who have been solicited by word of mouth. Since the private placement exemption does not prohibit payment of commission for sales agents, undoubtedly the sales force is pushing private placements to target groups, particularly the Hutterite Colonies in Alberta: query what the situation is outside the province. Although the issuer has yet to file any offering memorandum with their report of trade, there is the legal argument that section 16 of the Securities Regulations does not mandatorily prescribe the use of an offering memorandum. Accordingly, as long as Principal files the Form 20 following each exempt trade

under section 107(1)(d), under the present legislative scheme, it can engage in as many such trades as it wishes. There is no room for argument on my part that the issuer should be using a prospectus instead of using this particular exemption.

Were it not for the fact that Principal is engaged in some apparently bona fide business endeavors, one would be inclined to remark that the issuance of promissory notes with a delay of six to twelve months return of payment of principal and interest smacks of a classical ponzi scheme where new investors' monies are used to pay old investors out, the key being that there is an appreciable time delay in paying out early investors. We are aware of course that many investors may simply "roll over" their investments upon maturity, giving the issuer the additional funds and time to meet old commitments. We are also aware that Principal has the liberty of channelling funds and assets to meet particular regulatory requirements of certain of its entities, possibly to the deprivation of other unregulated entities. However, the inter-corporate maze has not been understood and only Don Cormie and Ken Marlin and other selected insiders really know what's going on. This may be a challenge for our Securities section should any new filings in the nature of public offering documents be submitted.

I do not have any further audit programs for the Principal Group of Companies. Given that we have detected no violations or mischief in selective review, you may discontinue any active procedures on your part and simply follow the Company's progress."

The Chairman of the ASC, when I interviewed him, reported that this investigation was never brought to his attention.

There is no evidence of further involvement of the ASC with the sale of promissory notes by PGL until a hearing was held in July of 1987, on the Motion of the ASC, resulting in the denial of the use of the exemptions allowing sale of the notes by PGL on July 17, 1987. That action came about as a result of ASC staff, on becoming aware of the cancellation of the registration of FIC and AIC under the ICA, and after seeking direction from the ASC, approaching PGL to ascertain whether up-to-date financial information could be made available so that the ASC could ascertain that accurate information was available to purchasers of promissory notes. After approximately one week of discussion between ASC staff and some officers and directors of PGL and their legal counsel, and after being made aware that such information could not be made available, the matter was brought before the ASC by the staff on the 16th and 17th of July, 1987. At the conclusion of the hearing, with the concurrence of PGL, all exemptions under the Securities Act were withdrawn by the ASC, effective July 1, 1987, and all monies received for the purchase of notes from July 1, 1987 to July 17, 1987 were ordered to be returned. That order was originally made as a confidential order, not to be made public, pursuant to section 19(m) of the Securities Act. On July 22, 1987, again on its own motion, the ASC reconsidered and revoked the confidentiality of the Order and made it public.

On August 10, 1987, PGL made a voluntary assignment into bankruptcy, appointing Collins Barrow Ltd. as trustee. At the time of the bankruptcy, approximately $86,500,000 in PGL promissory notes were outstanding. The best current estimate of the trustee is that barring any unusual developments, it is unlikely that noteholders could collect anything greater than 50 cents on each dollar owed, and it is likely that the recovery will be much less.

C. PRINCIPAL GROUP NOTEHOLDERS

In order to understand my conclusions, it is useful to review the issues which I have investigated in this section of my report. They are as follows:

(a) Whether the activities of PGL, combined with the knowledge of various officials and departments of the government about the affairs of it and of other member companies of the PGL group, should have caused the relevant departments or officials to limit or remove access to the exempt market by PGL;

(b) If so, whether failure to do so contributed to any losses incurred by any person or group, mainly, in this case, the noteholders;

(c) If such failure to act had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(d) Whether the exemptions in the Securities Act allowing such capital raising should be amended or modified, or whether policies or procedures to monitor such capital raising should be developed.

The Trustee in Bankruptcy for PGL, Collins Barrow Ltd., felt itself to be mandated to pursue the interests of the PGL noteholders, who form the largest body of creditors of PGL. As a result, Collins Barrow Ltd. made an extensive oral and written presentation to me. The argument advanced by Collins Barrow Ltd. that administrative failure by the Government of Alberta had contributed to the losses of the noteholders may be summarized as follows:-

(a) The government generally had extensive historical background information about the questionable operations of Principal Group from its regulation of the investment contract companies, FIC and AIC, and the early and questionable dealings with the Hutterite Colonies of Alberta by PS&T through the Hutterian Brethren Trust. That knowledge originally came from the Department of the Attorney General, which had responsibility for the ASC, then the regulator of FIC and AIC, and the Director of Trust Companies during the 1960's and 1970's.

(b) CCA, to which the ASC reported during the majority of the time promissory note sales took place, from 1980-1986, had extensive knowledge of the affairs of PGL through its monitoring of PGL's subsidiaries, FIC and AIC, by the Superintendent of Insurance under the ICA, and through monitoring of PS&T, as part of its role in administering the Trust Companies Act. This knowledge should have been communicated to the ASC, so that it might have moved earlier than it did to remove the exemptions allowing the sale of promissory notes by PGL.

(c) CCA was well aware that a demand of capital from PGL to assist FIC and AIC in meeting the tests under the ICA, would in turn result in PGL selling large amounts of promissory notes to the public as that was its only source of capital. It should therefore have acted to prevent such sales, because of its knowledge of the poor financial condition of FIC, AIC and PGL.

(d) The knowledge by CCA that all capital advanced to FIC and AIC from PGL was advanced on the security of subordinated promissory notes which contained terms preventing repayment of that money until all investment contract holders were paid or until the permission of the Superintendent of Insurance was granted should have caused officials of CCA to be alarmed about the situation of the purchasers of promissory notes. They should have communicated their concerns to the ASC, given their knowledge that FIC and AIC were likely to be unable to pay all investment contract holders.

(e) After 1984, at which time the Trustee concludes that FIC, AIC, and PGL itself were insolvent, it is alleged the Superintendent of Insurance, demanded two major capital injections be made into FIC and AIC by PGL, $11.3 million in 1984 and $11.25 million in 1986. He therefore deliberately acted improperly against the interests of the current and potential noteholders of PGL, in an effort to benefit investment contract holders. He was aware that the only source of capital for PGL was from its note sales, and because he was aware by the terms of the subordinated notes issued to PGL by FIC and AIC that PGL, and thus the noteholders, would not be repaid.

(f) Treasury, when it took over administration of the financial institutions in Alberta, including FIC and AIC and PS&T, should have communicated information to the ASC on a more timely basis, and, once the Superintendent of

Insurance came under its control, should have prevented the second capital demand in 1986.

(g) Finally, from 1980 onward the ASC, in any event, had sufficient evidence from other dealings with companies within the Principal Group that it should have moved earlier than it did to remove the exemptions available to PGL.

Certainly one of the most tragic and telling facts relied upon by Collins Barrow Ltd. in supporting its arguments, is that examination of the testimony of purchasers of promissory notes taken at the Code Investigation, and the interviews conducted by my office of noteholders, confirm that the majority of them could not be said to be sophisticated investors in any sense of the word. The Trustee provided me with a survey that further supports that argument. It is also clear that the sales people within the Principal Group attempted to confuse the noteholders by representing the promissory notes to be another form of deposit within the guaranteed or insured aura maintained by the Group because of the regulation of some of its subsidiaries pursuant to the ICA, and the Trust Companies Act, and membership of PS&T in the CDIC. Instead, they were high risk, uninsured and unsecured investments in a private unregulated company required to publish no financial information. It is also clear that salespeople took advantage of the fact that these investments were exempt from any regulation in marketing them, and revealed little financial information. When financial information was required to close the sale of a note, there was no hesitation and even encouragement to use erroneous and misleading information, such as the "1985 Annual Review" document.

In reviewing these arguments, and all of the evidence tendered at the Code Investigation and obtained during my further investigations, it is important to remember that my duty is to consider the actions of government administration "in the exercise of any power or function conferred...by any enactment" as section 11(1) of my Act requires me to do. Government administration does not function by intruding generally into every area of life to protect and ensure citizens against harm or potential harm from themselves or others; rather it functions within the confines of what it is instructed to do by the Legislature, as the representatives of the electorate.

Therefore, when the Legislature has instructed administration to do nothing, as they have done here by ordering sales of notes to be completely free and exempt from all regulation, a much higher threshhold of knowledge will clearly be necessary on the part of administration in order to find them liable for inaction than when they were required to administer a regulatory regime such as that imposed by the ICA. Since there is a complete absence of duty to regulate at all, there must be some specific complaint, or a fact of misuse of the exemptions, come to the attention of administration and be ignored, to support an argument of administrative shortfall.

I will deal firstly with the allegations against those involved with the investment contract companies, who, it is alleged, should have expanded their specific duties in order to give warning to the ASC. I will secondly deal with the actions of the ASC.

The first government official who questioned the capital raising practices of PGL and its predecessors as they originally related to Hutterite Colonies, was Dansereau, the Director of Trust Companies. He also caused some warning to be made to at least some of the Colonies involved. Dansereau properly reported his concerns to the Attorney General of the time. His prime objective was to return some control over their investment monies to the Hutterite Colonies. Even after receiving a legal opinion that the actions of PS&T in administering the Hutterian Brethren Trust were legal, Dansereau persisted. He ultimately was successful in causing the trust to be wound down, and insuring further investment by the Hutterite Colonies was made legally, in promissory notes. As a result the opportunity was given to them to make a decision whether or not to purchase notes, and to negotiate the terms of purchase, rather than the Trustee making that decision without consultation. His further objective was to improve the performance of PS&T so that it conformed with the requirements of his department, which objective, by the early 1970's, was achieved. I do not find any administrative error in the conduct of Dansereau or the other officials involved at the time.

The next series of events to be considered concerns the knowledge of the CCA about the activities of PGL in marketing promissory notes, and the relation of those activities to FIC/AIC, and to a limited extent PS&T, companies that department was required to regulate pursuant to the ICA and the Trust Companies Act. The first group of government servants whose conduct must be reviewed is that of the audit section and its supervisors, which for the time that I have investigated, would include Eldridge, Hutchison, Romalo, and Darwish. All of those persons testified during the Code

Investigation and three of them were re-interviewed, by me, in the case of Eldridge and Darwish, or by my investigators, in the case of Hutchison.

Eldridge was an auditor in CCA until 1983, at which time he became Director of Audits. Eldridge testified he was aware of the sale of notes through his review of PGL statements, which had been provided to him as part of his regular review of the affairs of FIC/AIC for the purposes of the ICA. He also, from time to time, reviewed the weekly summaries issued publicly by the ASC describing these sales of promissory notes. He was aware that note sales formed a large part of the capitalization of PGL and testified that if the indebtedness represented by the notes was all withdrawn, PGL would likely collapse. He stated emphatically when interviewed by myself, that while he knew note sales in the exempt markets might be one of the sources of capital for PGL, he did not consider any direct relationship between those note sales and the capital requirements of the investment contract companies, nor did he assume that the only source of capital of PGL was the sale of promissory notes. I do not find, in reviewing Eldridge's conduct, any administrative error. It must be understood that his duties were to conduct audits on companies complying with the ICA and the Trust Companies Act, and it is in the performance of those duties that I must review his conduct. He was not charged with the duty of being a watchdog of any and all financial conglomerates or holding companies within the province that may have owned or controlled a company whose affairs he reviewed. It was clear to him that PGL had extensive business interests other than its ownership of FIC and AIC. Indeed, with the limited information that he had,

had he attempted to interfere with the unregulated business activities of PGL in marketing promissory notes, he might have been subject to discipline.

The other auditors previously involved with FIC and AIC at CCA were Hutchison and Romalo. Their testimony was similar to that of Eldridge, although Hutchison was somewhat more specific in his view that PGL, from 1983 onward, was in poor financial condition and that he further understood that the sale of promissory notes was one of the main capital-raising activities of PGL. None of them made the specific connection in their own minds between the sale of promissory notes by PGL and the requirements of capital for FIC and AIC. I do not find that their concerns or their knowledge was specific enough that it should have caused them to raise their concerns about the sale of promissory notes by PGL, or the financial condition of PGL, with the ASC. Nor was their knowledge of note sales, nor their concerns about it, specific enough that they in any way breached their duty to their department or their supervisors in allowing the department to make capital requirements of the investment contract companies. Again, given their duties and responsibilities pursuant to the legislation under which they were operating, I think they might have been subjected to extreme criticism had they done so.

Darwish had been involved for approximately twenty five years with the supervision of FIC and AIC, firstly through the ASC reporting through the Attorney General, and latterly through CCA. He had originally been an auditor, had then been the Superintendent of Insurance, and then became an Assistant Deputy Minister whose duties included overseeing the Audit Unit that supervised those companies. Over his years in the department, he prepared a number of notes and memoranda about the history of PGL in raising capital from the Hutterite Colonies in Alberta. He was, until he left government service in 1984, after a dispute with the Minister of CCA, the one person in government who was the most knowledgeable about the affairs of FIC and AIC and PGL. Even with that knowledge, he did not believe it to be necessary or desirable to make any complaint to the ASC about the activities of PGL in raising capital by marketing promissory notes. His understanding, which appears to have been generally accepted throughout the department, was that he did not relate capital from FIC and AIC directly to the raising of capital in the exempt markets by PGL. It was always his view, which seems to have been generally shared, that the principal of PGL, Donald Cormie, was wealthy and would inject capital if pressed hard enough to do so, and he did not consider, in his own mind, that the marketing of notes was the sole source of capital. His knowledge of the noteholders' situation was very general. For example, in a memorandum of a lengthy meeting in June of 1984 with officials of the CDIC and senior CCA officials, including the Deputy Minister, Martin, the Superintendent of Insurance, Saleh, the Director of Trust Companies, Pointe, and himself, which discussed in detail the affairs of all of the regulated companies, FIC, AIC, and PS&T, he stated,

> "Listening to Mr. Hammond (the representative of CDIC), it was clear to me that his examiners had a very good knowledge of what was happening with the company. He also pointed out that the whole organization was like a pyramid and if one company went down, others would also probably go down. He pointed out that he was concerned about the parent company, namely Principal Group Ltd. (PGL). I stated that that company did not look to be in very good shape and if one eliminated the goodwill and properly

> valued assets, that it probably was in bad financial condition. He agreed entirely. Mr. Secot (phonetic) noted that PGL was financed to quite an extent by notes payable that came primarily from the Hutterites."

This quotation is typical of the general non-specific knowledge of the noteholder situation in the CCA that appears throughout the written documentation, the testimony at the Code Investigation, and the interviews conducted by myself and my investigators with officials of the department.

Saleh, the Superintendent of Insurance in charge of regulation of investment contract companies from 1983 to 1986, when the regulation of those companies was transferred to Alberta Treasury, testified he was generally aware of the raising of the capital in the exempt market by the issuance of promissory notes by PGL. His knowledge of note sales by PGL and its meaning was sketchy and confused and it was clear that he knew little about it. He at no time related that vague awareness to his requests for capital injections in FIC and AIC.

The Deputy Minister to whom he reported, Martin, testified to some general awareness of the raising of capital by promissory notes sold to the Hutterite Colonies in Alberta, but did not relate that directly to the investment contract companies and their regulation. In my interview with him, he had no recollection of any specific knowledge and did not relate his "hearsay" knowledge to anything specific as use or misuse of exempt capital markets, or the fact that such note sales might relate to capital demands of the investment contract companies by the Superintendent of Insurance.

The Minister of CCA, Osterman, remembers knowing of the sale of promissory notes by PGL, but could recall no specifics at all. She cannot, and did not, relate those notes to the affairs of the investment contract companies, nor can she recall it being raised by or with the ASC, which was administratively attached to her Ministry, while she was Minister.

Her successor as Minister, Adair, had no specific memory of the situation regarding the sale of promissory notes or any discussion of it.

It must be remembered that some of the factors that might have required CCA to act, or to govern their actions in making capital demands, were absent. For example, there is no evidence of any complaint made by any noteholder or anyone else concerning the business practices of PGL to the department. There was no indication from any investment contract holder or any customer of PS&T that they were being "steered" away from the regulated institutions into the exempt promissory note market. There were no complaints generally about sales practices regarding promissory notes. While hindsight may show that improper practices were taking place in the Principal Group's "financial centres", the actions of the department must be considered in accordance with the knowledge that they had, or should have obtained, and in these circumstances I do not find administrative error having regard to the knowledge CCA had, nor do I find any administrative error in their practices and procedures in obtaining such knowledge.

D. CONCLUSIONS FROM INVESTIGATION

Having reviewed all of that evidence, and all of the documentation tendered at the Code Inquiry, and the further documentation I obtained as part of my investigation, and even with the benefit of hindsight, I cannot find any administrative shortfall in CCA concerning the situation of the PGL noteholders. I do not think the knowledge of the poor financial condition of the two investment contract companies, together with the rather nebulous and vague knowledge of personnel in CCA about the sale of notes, and its possible relationship to the situation of the investment contract companies, should have caused formal communication to be made to the ASC.

It is important to note that during the relevant time PS&T, another institution which was also effectively a subsidiary of PGL, was being regulated by CCA and was not then in serious financial difficulties. There was also general awareness that PGL was involved extensively in other business activities, and was the largest and one of the most successful marketers of mutual funds in Alberta. As well, the regulators were fully aware that PGL was a private and completely unregulated company as far as any department of the Alberta Government was concerned.

As a result of these facts, I conclude that none of the officials of CCA made the specific cause and effect connection between the capital requirements of the investment contract companies, to a lesser extent PS&T, and the situation of the noteholders. I also cannot find that they were possessed of any duty, or indeed of any specific information, that should have caused them to be concerned. I therefore cannot find administrative error on their part. I believe there is considerable justification for these officials to have confined their efforts to the duties and responsibilities of their positions. It is not administrative error for them to have failed to understand and to attempt to correct a situation that, in my view, has only been revealed with the assistance of far greater investigation than they were able, or required by their duties, to do, and with the very considerable assistance of hindsight.

Certainly in the absence of any statutory duty I do not believe any legal liability could be attached to any of the personnel of CCA.

Regarding the failure of Treasury to communicate the information it had to the ASC in order to cause it to act, I have come to the same conclusion.

It is clear that Treasury did not earlier make the connection that to demand capital from the investment contract companies was to, in effect, cause detriment to PGL noteholders. The final injection of capital by PGL into FIC and AIC, which was made by PGL issuing to FIC and AIC promissory notes in the aggregate amount of $11.25 million, came about as a result of a demand by the Superintendent of Insurance, Saleh, on August 14, 1986. That demand was approved by Kalke, the person in charge of monitoring the activities of the investment contract companies at Treasury, who testified that Treasury was, by that time, in charge of the regulation of FIC and AIC, which is the reason the Superintendent had sought his approval prior to the demand for the capital.

It is clear however from interviews with Kalke and his testimony that any possible effect on the Principal noteholders or potential noteholders was no more present to his mind than it was to Saleh's. Even when the PGL noteholders' situation was fully considered by Saleh, in late May of 1987, the conclusion was that the advances from PGL to FIC and AIC, secured by subordinated notes, and the outstanding notes owing to FIC and AIC by PGL, was only one factor in the possible future insolvency in PGL.

As great a factor was the potential success or failure of business ventures within the Group, primarily the extensive and financially successful marketing of mutual funds, and a major concern of Treasury at that time was that the mutual fund business might be adversely affected by the removal of the licences of FIC and AIC. The view of the regulators, which I believe to have been justified given the facts they had, was that provision of capital to FIC and AIC to support them was only one of the business activities of PGL. That position was supported by the review of the financial information which was freely provided by PGL to the regulators in CCA and latterly in Treasury to assist in their regulation of FIC and AIC.

The audited financial statements of PGL showed at the time of its bankruptcy that while the amount owing to noteholders was $86,500,000, $33,500,000 of that represented capital advances to FIC and AIC, either by cash or promissory note to meet the demands of the ICA, and $64,500,000 was due and owing to CSI for other general purposes of the Group. This was consistent with earlier audited statements. Investment contract regulators had no means of ascertaining whether the advances to CSI were for proper business purposes, and had no statutory mandate to ascertain that.

Under the circumstances, I do not find any administrative error in a failure to directly relate a capital demand of a regulated company, whether FIC and AIC or PS&T, to the sale of promissory notes by PGL in the exempt markets. While the Code Investigation has clearly shown that the mutual fund business had been removed from PGL by this time, and CSI had diverted some of the noteholders' funds improperly, that was then unknown to the regulators at Treasury.

The main allegation against Treasury centers around its decision to build its own file of information, and not to rely extensively on the information obtained from CCA, although it did take over some of its personnel who had been involved in the regulation of the investment contract companies and trust companies. Again, while hindsight might dictate that a different decision could have been taken, I cannot find administrative error in making that decision, especially so in considering the indecisiveness of the officials who had been in charge, including Saleh and Martin, which I have discussed in detail earlier in this report. It is clear from my investigation that Treasury did not become aware of the large sales of promissory notes by PGL and its relation to the provision of capital to the investment contract companies, and to a lesser extent, the trust company until late May of 1987. They did go further in June of 1987 and made the necessary factual connection that gave them grave concerns about the situation of PGL note sales and noteholders. Once Treasury became aware of the facts, the evidence is clear that it communicated those facts to representatives of the ASC, which assisted the ASC in its decision to remove the exemptions allowing sale of notes in July of 1987.

That leads me to consideration of the actions of the ASC.

The first question that must be considered is whether the ASC, by the general knowledge it gleaned through dealing with regulated activities within the Principal Group of Companies, and its dealings with CCA and Treasury in carrying out such duties, should have removed the exemptions under which PGL marketed its notes earlier. The dealings with other entities within the Principal Group may be summarized as follows:

(a) Principal Consultants Ltd. ("PCL") was regulated as a registered mutual fund dealer by the ASC, which involved regular review of its financial situation to ensure that it possessed the necessary minimum free capital to maintain its registration. A minimum free capital requirement means that the company must possess sufficient cash or liquid assets over and above its obligations of a specific amount so as to satisfy the regulators it is of sufficient viability to carry out its business activities without any undue risk to those purchasing investments from it. These requirements are set out in the regulations to the Securities Act. It is clear that PCL continually maintained the necessary capital to satisfy the ASC at all times. PGL and other companies within PGL were recognized by the ASC as major and successful marketers of mutual funds in Alberta.

(b) FIC, beginning in early 1985, had considerable dealings with many of the staff of the ASC, as a result of the following:

(i) It made application and filed a draft Prospectus to allow it to market to the public a $50 million issue of its preferred shares, and at the same time an application was presented to allow PCL to sell those shares under exemption from the usual requirement that such shares would only be marketed by a registered securities dealer. A review of this application by the regulators is included at page of this report. In the end result, both applications were not proceeded with by the applicant, in the face of the expressed concerns of the ASC about the ability of FIC to pay the dividends to be attached to the preferred shares, the adequacy of disclosure of relevant financial information in the draft Prospectus, and questions about the ability of PCL sales people to offer independent financial advice about an issuance of shares by a related company.

(ii) As a result of FIC's application, concerns were raised about FIC's continuance as a registered mutual fund dealer. It was clear by early 1985 that FIC could no longer meet the minimum net free capital requirements, and indeed was in a deficit capital position. A complete review of the Mutual Fund Dealer registration is included at page 124 of this report. On July 8, 1985 Marlin in correspondence to the ASC surrendered FIC's registration as a Mutual Fund Dealer.

(iii) At the same time, review of the financial affairs of FIC led to a concern by the ASC that FIC did not meet the financial requirements to continue as an approved corporation under the Trustee Act of Alberta. A complete analysis of the regulators' actions with respect to FIC's continued registration as an approved Corporation under the Trustee Act is included at page 121 of this report. It is suffice to say here that registration continued to June 30, 1987.

(c) PCL extensively explored the possibility of registration as a securities dealer with the Commission in March of 1987, through a series of meetings between Petracca, representing PCL, and the Chairman of the ASC and some of the senior officials. The discussion resulted in the Chairman of the ASC requesting by letter that the Minister of CCA advise him if that department or Treasury had any concerns to report about the issuance of such licence as a result of their involvement with other companies within the Principal Group. No reply was forwarded to that request as before it was acted upon, action was taken against FIC and AIC by Treasury.

The real effect of all of the knowledge attained by or available to the ASC during this period of time was that FIC in particular, and other companies within PGL, in general, were in questionable financial condition.

All of the officials and employees at ASC who were interviewed regarding their dealings with the various Principal Group entitites described above, were questioned as to their awareness of the sale of promissory notes in the exempt market by PGL, and any reasons why they did not relate what they knew of the activities of Principal Group of Companies to the sale of those notes. None of those persons interviewed had more than a vague, general knowledge that PGL sold promissory notes, and none of them related the specific matters they were dealing with to the sale of those notes. They all stated that their interest was in dealing with the specific regulatory provisions that they were enforcing and with the specific companies that were being regulated, rather than the Principal Group in general. For example, Childs indicated emphatically that she did not consider the Principal Group as a whole or PGL as a specific entity within the Group. She further stated that the Commission did not generally think of such companies as a related whole, but concentrated on the specific companies within a group that were regulated.

Given the general purposes and requirements of regulation under the Securities Act, its regulations, and policies, I cannot find administrative error in the actions of those employees and officers of the ASC. Hindsight may show that these policies and procedures, and the statute on which they were based, were designed to deal with the traditional vertical structure of the financial industry, which was made up of what is called the four pillars, the banks, the trust companies, securities dealers, and the insurance industry. The regulatory legislation, regulations, policies, and procedures was designed to provide a specific system of regulation for each of those entities. The financial supermarket concept utilized by the Principal Group was difficult to regulate in accordance with that system.

The exemptions used by PGL were statutorily required to be available unless they were removed by reason of some enforcement action taken under section 116 of the Securities Act, on the basis that it was in the public interest to remove them. It is therefore important to keep in mind that no complaints from purchasers of notes ever reached the ASC until after the licences of FIC and AIC to sell investment contracts were removed.

As well, the purpose of regulation even for regulated companies under the Securities Act must be considered. In dealing with any application for approval of the sale of securities, the ASC must attempt to ensure that the risk in purchasing those investments is described in such a way that the ordinary, not the deemed to be sophisticated, investor will appreciate that risk and be in a position to evaluate it properly. There is no prohibition on high risk investment nor any requirement that those investments are in any way "safe". Therefore, knowledge by the ASC that a related company to the company seeking to market its securities was in financial difficulty would not prevent marketing of the securities. It would require disclosure of the financial condition of that related company, if the company marketing its securities was in some way responsible for the outstanding liabilities of that related company. In that case, the ASC would require disclosure of risk in the Prospectus that accompanied the securities marketed. Many junior companies in Alberta are allowed to raise capital to support an endeavour that would not succeed, or continue to exist, without that capital injection.

In the case of exempt investments, no such disclosure was required as the Legislature had decided it was for the investor, investing such large sums, and not the ASC, to obtain disclosure. It is now obvious, again with hindsight, that at least some of the persons selling promissory notes were misleading the purchasers by suggesting to them that these investments were in some way regulated or controlled by the Government of Alberta, or were in some way "safe" or were insured. I can find no evidence, however, of any knowledge of those practices regarding the sale of promissory notes by any person with the Government of Alberta prior to the removal of the licences of FIC and AIC in 1987, or indeed prior to the removal of the exemptions to sell promissory notes utilized by PGL in July of 1987. In the absense of such evidence, I cannot find any administrative error on the part of the employees of the ASC who were involved with other business activities within the Principal Group of Companies.

I do find that the involvement of the ASC, and specifically Lemay, in allowing FIC, or indeed any company, to maintain Trustee Act status and to be allowed as an investment for trustees, when it did not meet the requirements of the legislation, to be wrong. However, that wrongdoing only added one more piece of knowledge to the general knowledge at the ASC that FIC was in financial difficulty.

I further find the actions of Woo and Bertling during examination of PGL's use of those exemptions during 1985, to be reasonable and appropriate given the knowledge they had at the time. I do not think the comfort that Woo took in the large size of the transactions was unreasonable, again given the knowledge that he had, and the fact that the legislation under which he was operating exempted these transactions from review, in any event. In the absence of any complaint about note practices, he was justified, in my view, in concluding his investigation.

The fact that hindsight now shows that the majority of the investors were not as sophisticated as they might have been, given the large amounts of money which they had to invest, does not, in my view, change that conclusion.

It is clear that in almost every individual case that I have investigated, the noteholder appeared to understand he or she was purchasing promissory notes, rather than another type of investment. They almost universally were seeking higher interest rates. As well, it seems equally clear from my interviews with a number of different professionals throughout the Province of Alberta that had professional advice outside of Principal "consultants" been sought regarding the advisability of the purchase of such notes, cautions should have been raised. In individual cases noteholders who did seek such outside advice and were not cautioned may wish to consider exercising any rights of action they may have against those advisors. Counsel for Collins Barrow Ltd. admitted that had such independent advice been sought, caution would likely have been counselled. Certainly, even with the limited information available, the purchase of a promissory note by an investor who evaluated the aspects of that purchase objectively should have been considered to be an investment rather than a form of deposit.

Once the ASC became aware, in early July 1987, of information that would indicate that it was not in the public interest to allow PGL to continue holding the right to use exemptions under the Securities Act, I believe it moved in a timely and responsible fashion to remove those exemptions.

The situation of the noteholders is tragic. However, I cannot find it to be the fault of government administrators given the legislation regime they are operating under.

Certainly, in the absence of any statutory duty to act, and in the face of statutory provisions exempting such investments from any regulatory requirements, I do not believe there is any legal liability.

E. RECOMMENDATIONS

Given the fact that I have found no administrative error in the way in which government administration dealt with the situation of the sale of notes in the exempt market by PGL, I can only make recommendations which I hope will have some effect in preventing tragic losses such as those experienced by the PGL noteholders from taking place in the future.

In reviewing such recommendations, it must first of all be remembered that my offices do not possess the resources or the ability of a Law Reform Commission. My recommendations are, as a result, general in nature. I have been fortunate to have had the benefit of the Report of the Committee on Fair Dealing in Consumer Savings and Investment, issued to the Minister of CCA of Alberta in January of 1989. As part of my investigation, I interviewed Mr. Cashion, the Chairman of that Commission.

I concur in the recommendation contained in that report that section 66(d) of the Alberta Securities Act, which provides what has been called in this report the "negotiable instruments exemption", be either eliminated.

Cashion indicated to me that his Committee, which was made up of representatives of all facets of the financial industry, together with consumers, was unable to come to any conclusion concerning the acquisition cost exemption, granted under section 107(1)(d) of the Alberta Securities Act. It is my recommendation that the amount of that exemption be substantially increased to a minimum of $200,000.

After interviewing many of the note holders who lost money in the collapse of the Principal Group of Companies, it seems that with inflation, larger insurance settlements for injury or death, capital appreciation of homes and farms, and other such factors, that one should not assume sophistication unless the sums to be invested are sufficiently large. As well, I believe the Forms 20 and 20A required by the regulations pursuant to the Alberta Securities Act to be filed with the ASC evidencing exempt trades should also include a declaration by the vendor that the purchaser has been advised that this is an investment that is completely unregulated and has not been reviewed or approved by any regulatory authority. As an attachment to the form, a statutory declaration should be required from the purchaser stating under oath that such information has been communicated at the time of purchase.

I also believe that the current initiatives of government in legislation dealing wth sales practices in the White Paper discussed under my recommendations regarding FIC and AIC will go a long way toward prevention of a mass marketing of exempt securities such as happened here.

7. PRINCIPAL SAVINGS AND TRUST COMPANY

A. TRUST COMPANIES

(1) NATURE OF INSTITUTION

Trust companies may be created both under federal legislation and provincial legislation. Federally incorporated trust companies must register under provincial legislation within each province in which they operate. Trust companies are generally considered to be regulated and respectable financial institutions. They are considered an important component of what is generally referred to as the four pillars of the financial industry in Canada; chartered banks, life insurance companies, investment dealers, and, of course, trust companies.

Historically, trust companies began in Canada as managers of large estates with mortgage and other investment holdings, and have traditionally developed in the money management business. By the late 1970's, trust companies had developed to the point that they handled a number of major types of financial business. These being the traditional business of acting as executor of and managing sizeable estates, providing personal trust services for the management of investment funds through vehicles such as RRSP's, providing corporate services such as acting as trustees for the issuance of corporate bonds and as transfer agents for the issuance of shares, and providing management of pension fund investments for corporations and sometimes trade unions. These are basically called fee for service activities.

The most important aspect of the development of trust company business in recent years, however, has been the taking of deposits and the investing of those funds, primarily in mortgage loans, although other types of loans are now common, to earn profit. The object of this activity is to realize more return from those investments than the amount, including interest, to be repaid to the depositors.

One of the chief factors in the development of this business is that since 1967, CDIC has made available to trust companies deposit insurance, in the same fashion that it is available to chartered banks. The maintaining of deposit insurance with CDIC is a requirement in most jurisdictions for a trust company to be licensed. With regard to the personal deposit business, CDIC has put the trust company on a competitive basis with chartered banks. That protection currently insures deposits up to $60,000 per customer. For individual customers in the 1980's, there is little difference in the services available at a trust company or a bank, and it appears that the public has come to think of those institutions as being fairly interchangeable.

(2) RELEVANT LEGISLATION AND REGULATIONS

The relevant legislation to my consideration of the actions of the Alberta regulators in regulating the affairs of Alberta based PS&T is the Trust Companies Act, and the regulations passed pursuant to it.

The major provisions regulating companies operating under the Trust Companies Act are as follows:

1. Registration. No company can operate in Alberta unless registered under the Act. (s.155)

2. Deposit insurance. As part of that registration, a trust company must be insured by the CDIC. (s.159(4))

3. Unimpaired capital. The company, if registered in Alberta before January 1, 1976, must show unimpaired capital (meaning capital free of any obligation) of one million dollars, or two million dollars if registered after January 1, 1976. (s.159(1))

4. Limit on deposits. The total liability of a trust company to its depositors or purchasers of its investment certificates cannot exceed an amount dictated by the Lieutenant Governor in Council under the regulations particular to that particular institution, which amount may be less but no more than 25 times the amount of its unimpaired capital. Therefore, a borrowing to capital ratio is always imposed, usually less than 25:1. (s.109)

(5) Guaranteed fund. A trust company must set aside a fund equal to the total of the company's liability to its depositors and purchasers of its investment certificates. This fund is subject to strict rules as to its composition and liquidity in relation to the anticipation of immediate demand by depositors and investors. This fund is to be valued each month. The assets are to remain in Canada. (s.109)

6. Securities and Mortgages. A trust company is very extensively controlled as to what it can invest in, the percentages of value that it can loan against particular types of secured assets, and the total amount of its portfolio that it can invest in particular types of securities, by the Act and regulations. (s.117)

7. Prohibited transactions. A number of types of transactions, particularly non-arm's length transactions to related companies and individuals, are specifically prohibited. (s.137)

8. Financial information. A trust company must provide, on a quarterly basis, statements certified by affidavit showing all of its deposits and outstanding investment certificates and all assets comprising its guaranteed fund (s.171). On a yearly basis, it must, 60 days after its year-end, file a statement of its financial condition and affairs certified by affidavits of its auditors and its officers, directors, and senior management. (s.170)

It is clear that the legislation is designed to provide a high level of protection to the depositors, by requiring both unimpaired capital and a capital to liability ratio, together with strict rules for the investment of funds deposited.

(3) DESCRIPTION OF REGULATORY METHODS

The regulation of trust companies in Alberta has always been under the Director of Trust Companies, whose office is created under the Trust Companies Act. The Director has reported to different Ministers from time to time, as the administration of the Trust Companies Act may be and has moved to different departments. During the time periods covered by my investigation, administration of the Act has moved from the Department of the Attorney General, to CCA, finally, to Treasury.

It is important to note that the administration of the Trust Companies Act has always been with the same department and has always been carried out by many of the staff involved with administration of the ICA. The regulatory activities, no matter which department had the responsibility, have been carried out in the same way. In general terms, auditors who reported to the Director of Trust Companies and who were familiar with financial institutions would conduct a number of regular examinations of trust companies. They would conduct an informal or desk examination of the quarterly statements required to be filed, and once a year a detailed examination would take place based on the certified financial statements required to be filed on a yearly basis. This detailed examination would often include attendance at the premises of the trust company to verify information.

My investigation has disclosed little difficulty with the auditors obtaining information or being free to report on it through the entire time that PS&T was subject to regulation. This information was derived by the auditors in accordance with audit programs designed to deal with provincial trust companies, which were amended from time to time, and were in turn developed from a review of the provisions of the Trust Companies Act and regulations. The auditors would submit reports of their findings to the Chief Auditor or Director of Audits, who would in turn report to the Director of Trust Companies.

In the years following the creation of the CDIC, and the requirement that all provincial trust companies maintain a policy of deposit insurance with that corporation, it is clear from my interviews with the auditors and from a review of the records that a very detailed examination of the affairs of all provincially based trust companies, and in particular, PS&T, was conducted by auditors for CDIC. The result of those audits were made available to the Director of Trust Companies. As well, any concerns that CDIC developed about the operations of PS&T were communicated to the Director of Trust Companies.

It seems fair to say that the Director of Trust Companies was prepared to allow the detailed examination performed by CDIC auditors, and the more stringent requirements imposed on PS&T by CDIC itself, to take precedence over regulation by the Director of Trust Companies. CDIC clearly demanded more stringent financial controls in order to maintain its policy of insurance than the controls that could be enforced by the Director of Trust Companies under the Trust Companies Act and regulations.

The Director of Trust Companies, however, does have a number of powers to enforce regulatory requirements of the Trust Companies Act and Regulations. For example, he has the right to order the company to amend its investment portfolio to comply with the investment restrictions and liquidity requirements. He may order disposition of unauthorized investments or loans, or those that in his opinion are unreasonable or improper. He may require the bylaws of the company to be amended if he finds they are not in accordance with the Act or regulations. He may disallow assets, investments, or loans, as being unauthorized. If he becomes concerned that the value placed on real estate owned or taken as security by the company against a loan, or other investments shown on the books of the company as an asset, or other investments that are security for a loan on the books of the company, is excessive, he may order an appraisal. He then may cause the value of the asset appraised to be written down to the amount that might be realized from it, which amount may not exceed the amount of the appraisal. In general terms, all of the above decisions may be appealed by the company, first to the Alberta Court of Queen's Bench, then to the Alberta Court of Appeal.

The Director may further, if he forms the opinion that the company is carrying on improper or imprudent practices that are contrary to the best interests of the company, issue orders that such practices cease.

Finally, the Director may decide that a provincial company is not entitled to registration, in which case he must give his decision in writing. At that time the company has the right to ask for a hearing before him to review the decision, and to bring evidence that would cause him to change his decision. If the decision is affirmed, however, there is an appeal to the Court of Queen's Bench and the Alberta Court of Appeal. It may seem from this review that the Director of Trust Companies has substantially more power to control the day to day operations of a provincial trust company than, for example, does the Superintendent of Insurance over investment contract companies under the ICA.

The Director also has the right to make a special report to the Minister of the Department to which he reports if he is satisfied, for example, that the trust company has defaulted in its liabilities, or has contravened the Act and such failure is prejudicial to the interests of the depositors, certificate holders, creditors, or shareholders of the company. He may further make a report if the unimpaired capital of the company falls below either two million dollars or one million dollars, depending on when it was registered, if

(a) its assets are not properly accounted for,

(b) if its assets are not sufficient to give adequate protection to the depositors and investment certificate holders, or

(c) if there exists a state of affairs within the company of a serious nature prejudicial to the interests of the depositors, certificate holders, creditors, or shareholders.

As well, a report may be made if the company refuses or hinders examination of its affairs during a regular examination conducted by the Director. The remedies recommended to the Minister in such a report may include suspension or cancellation of the company's registration, the appointment of a receiver and manager or liquidator, if circumstances warrant, or that rehabilitation procedures as outlined under the Act be taken.

After such special report from the Director, the Minister may require the Director to make the company's registration subject to whatever limitations or conditions he deems fit. The Minister may himself provide time limits to remedy deficiencies in the assets, or the Minister may direct the Director to take possession of the assets of the company indefinitely or for a specific period. If the company then fails to meet conditions as set out above, the Minister shall by order direct the Director to take possession and control of the company's assets.

If acting under a plan of rehabilitation ordered by the Minister, the Director may take on all powers of the directors and shareholders of the company and may exclude all classes of agents and employees of the company including directors and shareholders from its operations, and assume all necessary powers to operate the company. In so doing, he is protected against any legal action for acts in carrying out these duties provided they are done by him in good faith. Further, if the Director in a special report to the Minister recommends the appointment of a receiver and manager, the Minister may in turn recommend that appointment to the Lieutenant Governor in Council and the Cabinet may make such appointment. As well, after a special report by the Director, which is concurred in by the Minister, the Lieutenant Governor in Council may make an order winding up the company.

Further, once a special report by the Director has been received, the Minister may direct the Director to suspend or cancel the registration of the company. The Director himself may suspend or cancel registration of the company if it is proved to his satisfaction that the company has become bankrupt or insolvent, dissolved, or a liquidator has been appointed to wind it up. Finally, the Director, once he has received the approval of the Lieutenant Governor in Council, may suspend or cancel the registration of a company if the company ceases to be the holder of a policy of deposit insurance issued by CDIC.

It has been made clear during my investigation by both a review of documentation and interviews with persons holding the office of Director of Trust Companies that while the Director possessed these powers in theory under the Act, in practice he would not exercise them without the approval of his Deputy Minister and Minister.

B. COMMENTARY AND ANALYSIS

Principal Savings and Trust Company ("PS&T") was incorporated on April 12, 1965, under the Trust Companies Act, 1960. The Company was part of the Principal Group, controlled by Donald Cormie and some business associates. It was originally owned and controlled by Collective Securities Ltd. ("CSL"), but within a short time, control was transferred to Principal Group Ltd. ("PGL"). It was founded utilizing unimpaired capital of $500,000, which was the requirement for the registration of a trust company at the time.

One of the major aspects of the business of PS&T was to act as trustee of a trust called the Hutterian Brethren Investment Trust, which was created to invest money on behalf of a number of Hutterite Colonies in Alberta. A complete review of the Hutterian Brethren Trust and PGL promissory notes is included at page 333.

It is clear from a review of the files of the Director of Trust Companies, which regulated PS&T throughout its existence, that the company early on developed and followed a pattern of operating to the very outside limits of the legislation and of challenging the regulators on every matter raised. This was the usual pattern of a regulated company within the Principal Group.

This ongoing difficulty with the major role of PS&T, as an administrator of the Hutterian Brethren Investment Trust, also led to other disagreements between the regulators and the trust company over the years.

The following is a summary of some of the more important events which took place during the period of regulation of PS&T.

In particular, on June 14, 1971, Dansereau, with respect to the annual report of PS&T as at December 31, 1970, recommended that PS&T be forced to divorce itself from the Principal group, given its activities of using trust funds to capitalize that group in its administration of the Hutterian Brethren Investment Trust. As well, he pointed out that the unimpaired capital of the trust company was deficient, which was a situation that had continued on and off since April of

1968, and recommended that an injection of capital be required. Dansereau made the same recommendations in his examination of PS&T's reports as at December 31, 1971, and December 31, 1972. In his comments about the 1972 annual report of PS&T, he recommended that the operation of the company should be absorbed by another trust company unless the owners were prepared to pay in substantial amounts of additional capital to meet the unimpaired capital requirements. He complained that Donald Cormie's approach to the Trust Companies Act was technically to comply with the bare minimum requirements, but not with the spirit and intent of the Act, and again recommended that the company be divorced entirely from the Principal Group.

On June 10, 1974, Dansereau made a special report to the Attorney General under the provisions of the Trust Companies Act. In the report, he stated that the poor results of PS&T made it the only Alberta trust company still a major concern to his office. He specifically complained of the unorthodox method of allocation of income and expenses through PGL, so that the actual financial state of the company could not readily be ascertained, and the unacceptable management agreement between PS&T and PGL which decreased its income and increased its operating expenses to what he believed to be an unconscionable level. He again stated that the Hutterian Brethren Investment Trust agreement was unconscionable. Dansereau's views are best summarized by quoting from a portion of that Special Report as follows:

> "This company's problems can be squarely attributed to Mr. Cormie's attitude towards the spirit and intent of The Trust Companies Act, and his unorthodox methods and

> practices of carrying on business. Mr. Cormie, I believe, would be most happy if he had a free hand in running his conglomerate devoid of any government legislation and its administrators. I can only assume from the information available to me, that Mr. Cormie must have spent countless hours devising ways and means to set up his empire, the Principal Group, so as to safeguard his operations from easy scrutiny and to make sure that he personally obtains by any means, the greatest return for himself. His private holding company which controls his empire is strictly a family affair. In order to capitalize his empire without having to go through the Alberta Securities Commission, a scheme was devised to circumvent the normal channels. His key to success in this regard, was the unilateral Hutterian Trust Agreement by which he obtained from three to seven million dollars from time to time from the Hutterites. This money was used to purchase the preferred shares of Principal Group Ltd. This document is the most unconscionable agreement I have ever seen in all my years being connected with trust companies and fiduciary matters."

As a result, Dansereau wrote to Mr. McCurdy, the President of PS&T, and directed certain steps be implemented without delay including

(a) termination of the management agreement between PS&T and PGL and

(b) a minimum of $200,000 in additional capital be paid into the company.

There was substantial disagreement from PS&T about the demands, and the basis for them as outlined in the Special Report, but in the end result the additional capital was paid into the company, although the management agreement was not terminated.

Dansereau continued to echo the same concerns in 1974, with respect to the December 31, 1973 annual report, and in 1975 with respect to the December 31, 1974 annual report.

However, things did begin to improve. On January 4, 1977, an examination of PS&T for CDIC, based on the December 31, 1975, statements, and the unaudited position as at October 31, 1976, reported improvements in capitalization and matching of investments to liabilities, both of which had been of concern in the past. The report still commented adversely on the company's philosophy of seeking high risk mortgages and attempting to turn over securities on a regular basis at a profit to compensate for (rather than enhance) earnings which should have been derived from the more traditional areas of a trust company's operation. As well, it commented that administration charges levied by the parent company, served to siphon off profits which would otherwise be retained, and effectively inhibited growth of PS&T as a self sustaining entity. However, on August 15, 1977, Mr. Dansereau reported in his annual examination of PS&T that for the first time, the company's unimpaired capital had surpassed one million dollars.

On November 30, 1978, Dansereau, in his annual report to the Minister for the year ending December 31, 1977, noted some very dramatic improvements. John Cormie had taken over as the company's president, and Dansereau noted that a change in the company's attitude and willingness to cooperate with the regulators was marked. In his annual report for the year ended December 31, 1979, he noted what he felt to be a phenomenal improvement, and not only had no real concerns of the operation of PS&T, but was quite complimentary about its performance.

There appeared no difficulty with the operations of PS&T, as far as the Alberta regulators were concerned, until 1982. From that time on, the major concerns with the financial viability and operations of PS&T, and demands of its management to remedy those concerns, primarily came from CDIC, either through the Department of Insurance, Canada, which monitored trust companies on CDIC's behalf, or from CDIC directly. My investigation has shown that the provincial regulators within the offices of the Director of Trust Companies were kept fully informed by CDIC, but did not take as active a part in the regulation of PS&T. That was partially because CDIC, in order to maintain its policy of insurance, demanded a higher standard in the operation of PS&T than the Alberta regulators. In particular, for most of the relevant time during my investigation, the Lieutenant Governor in Council had set the capital to liability ratio for PS&T at 20:1. CDIC, however, demanded a ratio of 15:1.

In 1982, CDIC began to express serious concerns about the weakness of the mortgage portfolio of PS&T. They were also concerned the capitalization of the company was being maintained by subordinated promissory notes from PGL. These subordinated notes represented an advance of cash or assets by PGL to PS&T. PS&T in turn gave back a promissory note in the amount of the advance, meaning a promise to repay that money when demanded by PGL. The subordination aspect was that no repayment would take place until the creditors of PS&T, mainly its depositors and purchasers of investment certificates, were repaid, and the permission of the Director of Trust Companies was obtained to the repayment.

CDIC preferred that capital be introduced by way of equity, meaning money advanced to the company in exchange for issuance of shares, which is a true injection of capital and not a loan secured by a subordinated promissory note. PS&T disputed the concern with injection of capital supported by subordinated notes, and requested that the company's liability ratio be raised to 18:1. By September 8, 1982, CDIC officials wrote to the Alberta regulators to report that John Cormie had made no concessions in respect to the subordinated notes or the fifteen times borrowing ratio being demanded. CDIC suggested it was important that the company adopt a "no growth" stance and that such be formalized either by way of a limitation of the company's licence under the Trust Companies Act, or by way of a written undertaking being given to the Director of Trust Companies and to CDIC.

By February 24, 1984, matters had come to a head. The Department of Insurance, Canada, examiners, on behalf of CDIC had completed an examination of PS&T as at November 30, 1983. 33% of the mortgage portfolio of the company was in arrears three months or more. The company's assets were heavily mismatched in comparison to its liabilities. The company was still not abiding by the expected 15:1 capital ratio, and the federal regulators remained unsatisfied with the six million dollars in capitalization supported by subordinated promissory notes. The most immediate concern was that specific reserves should be made available for loss on mortgages at a minimum of eight million dollars. PS&T was warned that if it did not respond to the concerns, it was likely CDIC would send a formal report to the company pursuant to Section 25 of the CDIC Act (Canada) which would be a first step towards cancelling PS&T's policy of deposit insurance with CDIC, which would in turn cause it to lose its registration as a trust company in Alberta.

As has been made clear, earlier in this report, in the summary of my investigation regarding the regulatory affairs of FIC and AIC, this could not be allowed to happen. PS&T was the key to virtually every facet of the operations of PGL, in that without the credibility of maintaining its own trust company as a clearing house for funds, and as a "flagship" and the benefit of being able to advertise CDIC coverage, the survival of the Principal Group was at stake.

To meet the demands of CDIC, PS&T entered into transaction #1 with FIC and AIC. A detailed outlined of transaction #1 is included at page 78, however, a brief review is noted as follows:

Under that transaction, on March 23, 1984, PS&T sold to FIC and AIC its interest in 19 mortgages and 4 properties, ownership of which had been obtained by foreclosure. Prior to the sale, FIC and AIC had each held portions of the interests, and increased their position by purchasing the interests in those mortgages and properties held by PS&T. The terms of the sale required a cash payment of $23,245,129, which represented the book value of PS&T's interest in the said mortgages. That cash payment was made to PS&T even though it was clear that the mortgages and properties were worth nowhere near that value.

The fact that the majority of the mortgages were in arrears, and a substantial amount of the outstanding balances consisted of capitalized arrears, and the properties had been taken by way of foreclosure, is a clear indication they were not worth the amount owed on them which was the amount used to calculate their book value. As has been set out in detail earlier in this report of my investigation, it is clear that the Alberta regulators, both with the office of the Superintendent of Insurance regulating FIC and AIC and the office of the Director of Trust Companies regulating PS&T, were aware that this transaction was made to satisfy CDIC and to maintain the registration of PS&T. There was no attempt by executives of the Principal Group to conceal this fact; it was specific and disclosed in both correspondence and discussion.

The Superintendent of Insurance, Saleh, was highly concerned about this transaction and by letter dated May 11, 1984, to FIC and AIC, ordered that the transaction be reversed. However, after negotiation, he accepted an injection of cash into the Investment Contract Companies by PGL in exchange for subordinated promissory notes, and allowed the transaction to stand.

Even after this transaction, however, serious concern began to surface about the operation of PS&T.

Pointe, the Director of Trust Companies of Alberta, was concerned that the mortgage payout by affiliated companies which was part of transaction #1 might well violate section 138 of the Trust Companies Act.

On June 29, 1984, CDIC wrote John Cormie saying the purpose of the letter was "to report to you that CDIC is of the opinion PS&T is following unsound business or financial practices in that its total indebtedness in respect to monies borrowed by it is substantially in excess of the limit the corporation believes is appropriate." The report was made pursuant to section 25 of the CDIC Act. John Cormie, as President, was to present the report to a meeting of the Board of Directors of the company within 30 days of the date of its receipt. Should the company not correct the unsound business practices notice of termination of its policies of insurance could follow. A copy of the report was forwarded to the Minister of CCA, the Deputy Minister, and the Director of Trust Companies.

On August 13, 1984, Pointe wrote to Saleh with respect to a proposal by PGL to purchase Executive Trust Company in Ontario. The regulators had concern with PGL's financial circumstances and therefore could not support the acquisition. In addition, it was proposed that Marlin be a Director of Executive Trust Company. This he could not do if he remained a Director of PS&T.

On August 20, 1984, Hutchison wrote to Eldridge, Senior Auditor, with respect to a field audit of PS&T during May and June of 1984. The audit was to determine PS&T's financial stability and its adherence to the Trust Companies Act and regulations. The audit concentration was on the June 30, 1984, figures. During the first six months of 1984 substantial changes had been made to the financial condition of the company. For example:

(1) $2 million in capital had been injected,

(2) transaction #1 had taken place,

(3) a $6 million subordinated note had been converted to permanent capital,

(4) profit for the first 6 months was $38,000 and the company had started to set up reasonable reserves for bad debts on mortgages and real estate,

(5) the company's real estate holdings dropped from $8.4 to $5.2 million.

An additional $6 million in subordinated notes injected at the request of CDIC in June brought the borrowing to capital ratio at June 30, 1984 to 9:1.

The serious concerns were:

(1) should the Government of Canada bonds held by PS&T be written down to market, the company's unimpaired capital would drop by $8.694 million,

(2) CDIC requested PS&T to dispose of their long-term bond portfolio - this could result in an $8.6 million loss,

(3) the company was in a potentially serious situation of mismatch of assets with current liabilities,

(4) serious problems continued in the mortgage and real estate portfolio,

(5) the company had commenced foreclosure action on mortgages worth $8.9 million or 31% of their portfolio,

(6) a third of their mortgage and real estate portfolio was over three months in arrears,

(7) there appeared to be a violation of the Trust Companies Act Regulations with respect to the amount of security on loans,

(8) the regulators felt transaction #1 was a violation of section 138 of the Act.

A second transaction was entered into by PS&T, FIC, and AIC, primarily, from PS&T's part, to alleviate CDIC's concerns about matching of assets with liabilities and to cause amendment to the financial statements of PS&T that might alleviate concerns of the regulators. This was called transaction #5 in the Code Investigation, and was a transaction with a company known as General Equities Holdings Ltd. ("General Equities"), which involved its wholly owned subsidiary, Shucksan Properties Inc. ("Shucksan"). This transaction took place in June of 1985, and was very complicated. Transaction #5 is detailed at page 119.

Further concerns were raised by the Director of Trust Companies with PS&T in October of 1985 as a result of the annual report of December 31, 1984, and the update to June 30, 1985. Six loans secured by mutual funds showed balances in excess of the security margins allowed by up to 24%. 50% of the mortgage portfolio was six months or more in arrears, and the value of the properties mortgaged was not supported by any appropriate independent appraisal reports.

In November of 1985, CDIC first proposed to the Department of Consumer and Corporate Affairs that they undertake a joint investigation of PS&T. During late 1985 and early 1986, extensive correspondence was exchanged between John Cormie and CDIC officials about the affairs of PS&T. CDIC rejected John Cormie's representations that the company was in better condition as a result of recent transactions, and should be allowed a 20:1 capital to borrowing ratio rather than the 15:1 ratio that CDIC was attempting to impose. They also raised serious concerns about the General Equities/Shucksan transaction.

During the spring of 1986, CDIC continued to press for a joint examination of the affairs of PS&T and FIC and AIC which they believed to be closely related. Such a review was never done, because the 1985 financial statements of FIC and AIC were not filed by the required date of March 31, 1986, and it appeared that the provincial regulators were not anxious to have that come to the attention of CDIC. In the end result, a joint examination was carried out on PS&T alone, with four examiners, two from CDIC and two from the Audit Unit of CCA. Serious concerns were raised by CDIC, including the fact that PS&T continued to pay dividends in spite of the poor quality of its assets. A further issue came up regarding investment by PS&T in mutual funds managed with the Principal Group of Companies. The auditors reporting to the Director of Trust Companies felt that such investments were not authorized under the Trust Companies Act. Conflicting legal opinions were obtained, and PS&T disputed the fact that such investments were not approved.

In June of 1986, responsibility for the regulation of trust companies was transferred to Treasury. It must be noted that in August of 1986, the Deputy Provincial Treasurer, in a report to the Minister, indicated dissatisfaction with the method of carrying out the regulatory functions of trust companies. For example, the audit and examination reports prepared for trust companies and credit unions did not include critical and required information. McPherson, the Deputy Provincial Treasurer, felt that it was now necessary to amend the audit and examination procedures so that as well as reporting on the statistical and administrative information, the basic issue of the current or projected health of the trust company or credit union would be reflected. From that point on, Treasury did attempt to gather its information in such a way to reflect the overall financial health of trust companies, including PS&T.

In October of 1986, PS&T again sought the permission of the federal Department of Insurance, who handled investigations for CDIC, to approval of lowering the capital to borrowing ratio to 20:1. Certain interim financial information in that regard was promised to support the request. CDIC refused to grant the request, citing the failure of PS&T to provide the information promised. During November and December of 1986, there was considerable discussion between PS&T and officials of the Director of Trust Companies, including Pointe, the Director, about PS&T trading low and non-performing assets plus cash for assets of higher quality. That was the type of transaction that had begun to concern the regulators. The question being asked was whether such transactions were only to improve the appearance of the financial statements of PS&T, or were in fact for the benefit of the company. That proposal was not proceeded with.

On March 25, 1987, the federal Department of Insurance, on behalf of CDIC, completed its examination of PS&T for the year ended December 31, 1986. A copy of the review was forwarded to the Director of Trust Companies and received on April 8, 1987. Substantial concerns were disclosed in that review. Although PS&T had recognized considerable losses in 1986 on disposition of properties to associated companies, the federal regulators believed that additional reserves were required. The company disputed the amount, because if the reserves required by the federal regulators were set up, the capital to borrowing ratio of the company would deteriorate to 34.3:1. Even without the addition of the reserves required to reflect further losses on mortgages and real estate, the capital to borrowing ratio exceeded the CDIC set limit of 15:1, but was within the terms of the Alberta Act and Regulations, as it was less than 20:1.

A second major concern was PS&T's very close association with other Principal Group companies, of which FIC and AIC were considered to be particularly weak. As well, the payment of dividends was again criticized as it constituted a heavy drain on PS&T's borrowing base.

Another great concern was that the auditors of PS&T had indicated that unless the question of property evaluation was resolved, they would issue a qualified audit opinion. Although that was resolved, it was noted by the federal regulators that the external auditors to PS&T had significant concerns about it and the related companies within the Principal Group.

Another major concern was that 120 replies had been received to 150 queries which had been sent to clients who purchased investment contracts issued by FIC and AIC. An analysis of those who responded showed,

(a) 68% had purchased their certificate at a PS&T branch office,

(b) 41% were not aware that no CDIC insurance existed on term certificates, and

(c) there was great concern that cross selling techniques were being used by the Principal Group based on the existence of CDIC coverage for investments with PS&T.

CDIC continued to be concerned about this issue of cross selling and the assumption by purchasers of investment contracts from FIC and AIC that CDIC coverage was provided. They brought those concerns to the attention of the Director of Trust Companies in May of 1987.

As well, in May of 1987, the audit staff of the Director became concerned about what has been referred to as transaction #19 in the Code Investigation, and Visman of the Audit staff prepared a report to Pointe which was shared with officials for CDIC. Transaction #19 was a transaction whereby effective December 31, 1986, FIC purchased PS&T's interests in five mortgages and 32 owned properties for $9,220,332 cash.

Although the transaction was made effective December 31, 1986, and therefore the infusion of cash was of substantial assistance to PS&T in the preparation of their financial statement for the year ending December 31, 1986, CDIC regulators were still concerned about the viability of the company based on their examination of that financial statement.

The rationale given for the transaction was that FIC was better able to manage the properties purchased. It was felt the properties should be under one ownership in order to maximize the return from them. Only a small portion of the properties had been jointly owned by FIC and PS&T prior to the purchase. In the end result, the Director ordered this transaction to be reversed on June 29, 1987, one day before the registration of FIC and AIC under the ICA was removed.

On June 2, 1987, a draft report was prepared by the federal Department of Insurance on behalf of CDIC, addressed to John Cormie, the President of PS&T. That report raised a number of the concerns that had arisen over the past, including the fact that since 1984, PS&T had rarely operated within a capital to borrowing ratio of 15:1, and had ignored repeated requests for the injection of additional capital. It again raised the concern of cross selling of uninsured deposits in FIC and AIC. It raised the concerns of a large portion of the mortgage portfolio not meeting CDIC requirements. In the end result, that report required PS&T to remedy the problems in a prescribed time or a report would be forwarded by CDIC under section 25 of its Act, which would likely result in cancellation of a deposit insurance of PS&T. That report was the subject of substantial discussion between officials of the Director of Trust Companies, the federal Department of

Insurance, and CDIC.

On June 19, 1987, a final letter based on the draft was forwarded to John Cormie, signed by Charles C. de Lery, President and Chief Executive Officer of the CDIC, in which John Cormie was given three weeks to respond to the concerns raised in the letter. A copy of the letter was forwarded to the Deputy Provincial Treasurer, McPherson.

Following the cancellation of the registration of FIC and AIC under the Investment Contracts Act on June 30, 1987, CDIC retained B. I. Robertson and Associates Ltd. ("BIRA") to conduct a special review of PS&T. That review disclosed that the collapse of FIC and AIC had a negative impact on PS&T's revenues as well as administration costs. The report further provided that PS&T was not meeting CDIC's guidelines, as it was not within the required borrowing to capital ratio, nor were its operations being conducted in accordance with sound business and financial practices. As well, CDIC concluded from the report that the equity of PS&T shareholders had completely eroded by June 30, 1987. CDIC therefore concluded it was not prepared to continue insurance coverage unless PS&T's shareholders, including PGL, were willing and able to inject additional capital into the company.

The Alberta regulators were also concerned and a letter was forwarded to John Cormie on July 7, 1987, by Pointe relating to the statutory examination of PS&T for the year ended December 31, 1986, and a review of the monthly reports to April 30, 1987. That letter required that the company immediately prepare and forward to the Director of Trust Companies a business plan demonstrating the continued viability of the company. As well, it required that PS&T take the necessary steps to maintain its policy of deposit insurance under the CDIC Act. As well, compliance with the Act, by reason of some changes in accounting procedures and certain investments, did not meet the guidelines. A response was requested to all of the matters raised in the letter by July 28, 1987.

Discussion ensued between CDIC, the Director of Trust Companies, and representatives of PS&T, during which time PS&T and PGL were granted the opportunity to raise additional capital or to seek suitable buyers for the PGL group or some of its components including PS&T. Those efforts proved unsuccessful and on August 10, 1987, PGL, the controlling shareholder of PS&T, made an assignment in bankruptcy. The same day, Pointe issued a special report to Johnston, the Minister, under section 184 of the Trust Companies Act, recommending that proceedings be taken against PS&T under sections 185 and 186 of the Act. The reasons given were that PGL, the controlling shareholder,

(1) had made an assignment in bankruptcy,

(2) FIC and AIC, two affiliated companies, had applied for order under the Companies Creditors Arrangement Act and

(3) CDIC had communicated to the Director of Trust Companies that it was of the opinion that PS&T was insolvent or about to become insolvent and would be making an application to the court for an order that PS&T be wound up.

As a result of all those matters, the Director of Trust Companies concluded there existed a state of affairs within PS&T of a serious nature that was or would likely be prejudicial to the interests of PS&T's depositors, investment certificate holders, creditors or shareholders. On the same day, Johnston directed the Director of Trust Companies to take possession and control of PS&T's assets. Pointe, the Director of Trust Companies, in response issued an order taking possession and control of PS&T's assets and the conduct of its business. The order exluded the directors, employees and agents of PS&T from the property and business of the company except as permitted by him and appointing BIRA to conduct the business of PS&T. A court order was granted on August 17, 1987, in the Court of Queen's Bench of Alberta, ordering that PS&T be wound up and BIRA be appointed as liquidator. Finally, on August 17, 1987, the Director of Trust Companies also appointed BIRA as trustee of the trust assets held by PS&T.

C. CONCLUSIONS FROM INVESTIGATION

In order to understand my conclusions, it is useful to review the issues which I investigated in this section of my report. They are as follows:

(1) Whether there was any failure in the regulatory process;

(2) If so, whether that failure contributed to any losses incurred by any person or group, including:

(a) Depositors,
(b) Employees,
(c) The owners of the company, as a result of the company being taken over and wound up;

(3) If regulatory failure had contributed to such losses, whether any remedy should be recommended to mitigate those losses;

(4) Whether the regime of regulation, either the statute and regulations, or the policies and procedures developed in administration of them, or both, were faulty and should be amended.

At the time of the drafting of this report, it is not yet clear whether there will be any loss to depositors of PS&T. Most of those deposits qualify for CDIC insurance, which in general terms will cover those with $60,000 or less on deposit if the deposit is for a period of less than five years. At the moment, the best projection with respect to the uninsured deposits is that there will either be a slight loss, or if assets are liquidated favourably, enough funds will be generated to cover all claims of depositors. Therefore, I have not, in my conclusions or recommendations, dealt with the issue of losses to depositors. My conclusions deal with the issue of whether the actions of government regulators or the system of regulation was wrong or unfair, and as a result caused loss to the employees or owners of PS&T by causing PS&T to be wound up when it should not have been.

John Cormie, who had been President of PS&T, and in charge of its operations prior to the company being liquidated, made a specific and detailed complaint to me about that issue. The nature of this complaint may be summarized as follows:

(a) He stated that an analysis of all financial information available leads to the conclusion that in August of 1987, PS&T was solvent and was in no immediate risk of becoming insolvent. He provided an extensive analysis of financial and operational data of PS&T to support his argument. He specifically stated that PS&T was effectively managing the crisis caused by the removal of the registrations of AIC and FIC on June 30, 1987. The current projection that there will be little or no loss to depositors certainly assists his argument.

(b) As a result, he says that the exercise of the power by the Director of Trust Companies and the Provincial Treasurer to take control of and liquidate PS&T was improper, and was done without consultation or notice to PS&T, to the prejudice of the uninsured depositors, the shareholders, the creditors of PGL (the majority shareholder), and the interests and reputation of the management and employees. He also says that the loss to the creditors of PGL is compounded by the difficulty caused to the mutual fund clients of the Principal Group, as PS&T was the vehicle used to manage the assets of mutual funds.

In dealing with that argument, it must be remembered that an Ombudsman investigation, as I stated in the introductory section of this report, looks at actions of departments or officials to determine whether they, in my opinion, violate the tests set out in section 20 of my Act. An Ombudsman is not a judge or other tribunal; he (or she) is a generalist and not an expert in a specified area. Therefore, when I examine decisions such as those made by Pointe, the Director of Trust Companies, and the Minister, Johnston, I can be (and should be) satisfied if those decisions are reasonable ones given the facts that they had and the circumstances under which they were operating, even if it could be argued that the opposite decision could have been taken, provided I am further satisfied that they acted in good faith.

Applying those standards, I can find no evidence that Pointe or Johnston, or members of their staff, acted improperly in exercising the discretion to take over the operations of PS&T on August 10, 1987. I cannot find any failure on their part to follow the specific provisions set out in the Trust Companies Act, and I believe they acted legally throughout.

In my view, they considered all of the relevant facts, and made a supportable decision, which was clearly motivated by concern for the uninsured depositors. They believed that the continual and expanding adverse effect of the cancellation of the registration of FIC and AIC, together with the impending bankruptcy or other arrangements of insolvency reorganization of PGL, would continue to cause deterioration in the affairs of PS&T and continually increase the risk to the depositors. Clearly, a company that owed its existence to its association with the Principal Group would have great difficulty throwing off that association in the mind of the public in light of these events. As well, CDIC had advised that it saw no possibility for survival of PS&T and that it was prepared to move to cancel the deposit insurance. That would inevitably result in the takeover of the operations of PS&T, in any event. In the circumstances, immediate action was felt to be necessary, and was taken. I cannot find fault with that action.

Any comments that I have regarding the knowledge obtained and decisions taken during the general history of the regulation of PS&T, as that involves the larger question of the other operations of the Principal Group examined in this report, are contained in the comments in the sections dealing with investment contract companies and companies that deal in exempt securities.

D. RECOMMENDATIONS

Given that I have not found any administrative error or fault in this section of my report, I have no recommendations. I have made specific recommendations regarding legislation for deposit taking companies, including trust companies, elsewhere in the report under the sections dealing with investment contract companies and companies that deal in exempt securities.

8. DESTRUCTION OF MINISTER'S PAPERS

A. SUMMARY OF INVESTIGATION

On October 5, 1988, a formal complaint was received from Cheryl D. Brown, President, Principal Investors Protector Association, requesting me to investigate the destruction of Osterman's papers and other relevant materials from her tenure as Minister of CCA. The destruction of those papers had come to light at the time Osterman prepared her testimony for the Code Investigation. She had been aware of it some months earlier, but the information had not been disclosed until testimony preparation.

In conducting the investigation, I was provided with the internal investigation conducted under the direction of Dr. B. Mellon, Deputy Minister, Executive Council, which appeared to be very thorough, together with all background documentation.

My investigator personally interviewed all of the persons involved after a full review of the documentation.

My investigator also examined the basement area of the Legislature and observed the various vaults available for use for the storage of papers of Ministers. The word "vaults" is somewhat of a misnomer; they can best be described as areas enclosed with wire fencing containing shelves and having padlocks on the doors.

The following are the circumstances surrounding the destruction of the files. Prior to the 1986 election, the vaults located in the basement of the Legislative Assembly were assigned by portfolio and not by Ministers' names in order to ensure that all departmental records were maintained in one central location. When changes in portfolio occurred, constituency and personal files were moved. At the end of each term, Executive Council requested that the vault areas be cleaned but many of the incumbents retained their files and merely requested additional space. After the 1986 election, it was established that there was insufficient area for file storage and a project was undertaken to have stored material reviewed, archived, or destroyed. This project was undertaken by Executive Council under Joyce Ingram, Deputy Secretary of Cabinet, co-ordinated by Brian Hlus, and carried out by Wanda Kolba. There was no written policy on the disposition of ministerial records. Although such a policy had been proposed in 1981, it was not of high enough priority to be reviewed by Cabinet.

In February, 1986, Osterman left the CCA portfolio to become the Minister of Social Services. Osterman transferred her CCA current files to Adair, the new Minister, who was advised that the remainder of the material was stored in the CCA vault.

On April 1, 1987, work commenced on the clean-up of vaults by employees of Ministers. The person carrying out this project was Kolba who contacted the Ministers' offices, usually through the Minister's secretary or Executive Assistant. Any surplus material was transferred to vault number 11 where it was held for review by various staff. Once material had been reviewed by the Minister's staff, it was placed in boxes, sealed and put in vault number 46 which was referred to as the "burn vault". From this vault material was taken to Fort

Saskatchewan Correctional Centre where it was burned. It is interesting to note that the burning was intended to take place at the incinerator at the Fort Saskatchewan Correctional Centre. In discussion with the Public Works, Supply & Services employees at the old Fort Saskatchewan Correctional Centre, as well as the new one, my investigator learned that the incinerator at the jail had been destroyed in 1984. It was established that the method utilized to destroy the Minister's files was to dig a hole on the bank of the river at the rear of the old jail, place the documents into the hole, obtain permission from the Fire Chief at Fort Saskatchewan, and then light the documents in order to destroy them. The actual lighting and destruction of the documents was conducted and supervised by Public Works, Supply & Services employees from the Legislative Building.

The CCA vault was vault number 5 and contained Ministers' records of Harle, Dowling, Koziak, Osterman and Adair. In May, 1986, this vault was assigned to the incumbent Minister Elaine McCoy.

The Executive Assistants of the former Ministers were contacted and it was learned that Harle's and Koziak's files were reviewed at the time of their portfolio changes and what remained was left to the discretion of the current Minister McCoy. Dowling personally attended and reviewed his material and authorized that the files be destroyed. This left only Osterman's files.

Kolba initially contacted Osterman's Executive Assistant, Doug Cameron, who indicated that he was preoccupied with the session of the Legislature and did not, at that time, have freedom to review the files. Subsequently, Kolba dealt with Tom Burns, Osterman's Executive Director in the Department of Social Services and Community Health, and was left with the impression that she was to coordinate the destruction of CCA files with Osterman's secretary, Theresa Boyes. Kolba states that she dealt with Boyes who indicated that the only files Osterman wished to retain from the CCA vault were her constituency files which were contained in orange colored file folders. The remaining files were gathered together and referred to McCoy as to their disposition. McCoy had James Blower, the Director of Records at the Department of Consumer and Corporate Affairs, review the files, retain those of importance and dispose of the others. Blower reviewed the files by file caption only, retained those which he felt would have been of use to the department, and the remainder were handled in accordance with the Public Service Guidelines for file retention and destruction. Those set up for destruction were removed from vault number 5 and placed in the burn vault number 46 and as near as can be established were likely burned on June 29, 1987.

It was not until September of 1987 when Osterman directed her staff to retrieve some of the files for review in relation to the collapse of Principal that it was established that all of the files which she was desirous of reviewing had been destroyed during the course of the vault clean up project.

B. CONCLUSIONS FROM INVESTIGATION

There are two conflicting statements regarding the instruction as to the disposition of Osterman's CCA files.

The first version comes from Osterman's staff and the second version comes from Wanda Kolba, the person who received the instructions. Osterman's current staff state they never gave instructions to Kolba to destroy the files in the CCA vault. Kolba's position is that she was directed to Terry Boyes who told her to have the files reviewed by McCoy and they could then be destroyed. The only ones to be retained for Osterman were the constituency files. Without any independent witnesses to these conversations, I am unable to ascertain which view is correct. Certainly, it is clear that Kolba operated on the understanding that she had those instructions.

My investigator made extensive enquiries to attempt to establish if any of these files had been reviewed by Osterman's staff after McCoy became Minister of CCA. There is no evidence that would confirm that any of Osterman's staff attempted to review any of the files, by either obtaining the master key or the departmental key to the vault in question.

I personally interviewed Osterman concerning this matter, as well.

I am satisfied that the destruction of these files took place through inadvertence, and through the normal procedures that were established as part of the vault clean-up project under the direction and control of Executive Council. I was unable to establish any evidence to indicate any conscious effort by anyone to destroy files in order to hide the content, nor is there any evidence to link the destruction of the files to any events surrounding the regulation of any company within the Principal Group.

I accept Osterman's testimony at the Code Investigation and her statements to me that the files were destroyed without her knowledge, and that she was highly annoyed when she discovered that. It is unfortunate the files were destroyed, because they might have shed some light on the crucial point of what information and recommendations Osterman was receiving from Saleh and Martin.

C. RECOMMENDATIONS

The recommendations as a result of this part of the investigation are very straightforward. In the first place, a proper procedure needed to be developed in order to deal with Ministerial records and the vaults in question. The policy was developed on the 14th of December 1988. I believe that policy to be appropriate.

Secondly, government, as is to be expected, has substantial policies concerning records management and records disposition, developed by Alberta Public Works, Supply & Services. There is nothing wrong with these policies; they simply need to be followed, and I recommend that they be carefully followed in every instance.

Finally, the somewhat absurd and certainly dangerous method of destruction of documents should never be repeated. One might speculate on the effect of a sudden high wind at the time the documents were being thrown into the pit to be burned or were being burned. I am pleased to report that a shredding machine has now been installed in the vaults, and more appropriate procedures are going to be used for destruction of documents.

9. EXHIBITS LIST

Page

1. Press Release of Provincial Treasurer 406

2. Analysis of Complaints Received by Ombudsman 407

3. Correspondence Relating to Ministerial Order and Press Release of Ombudsman 408-414

4. List of Statutes and Authorities Considered 415

5. Principal Group Corporate Chart 421

6. Principal Group of Companies Chart Referred to in Ombudsman Report 422

7. Associated Investors of Canada and First Investors Corporation Application Form 423

8. Associated Investors of Canada and First Investors Corporation Application Form 425-426

Exhibit 1

Alberta

NEWS RELEASE

GOVERNMENT OF ALBERTA

FOR RELEASE: Tuesday, June 30, 1987 at ~~4~~5:30 p.m.

Provincial Treasurer Dick Johnston today confirmed that First Investors Corporation and Associated Investors of Canada, subsidiaries of Principal Group Ltd., applied to the Court of Queen's Bench for an Order appointing Coopers & Lybrand as a manager under the Companies Creditors Arrangement Act and have been granted the Order. The application followed provincial cancellation of the registration of the two companies to raise money from investors pursuant to the Alberta Investment Contracts Act.

Mr. Johnston indicated discussions have been ongoing with the companies as a result of provincial concerns about their ability to make full payment of their obligations under outstanding investment contracts. The Treasurer stated that the utilization of a plan of arrangement under the Companies Creditors Arrangement Act was chosen based on providing the Investment Contract holders with the greatest chance for maximum recovery of amounts owed to them. Investments by contract holders are not insured deposits.

Mr. Johnston indicated he regretted the necessity for these two contract investment companies to take these steps but that protection of the investment contract holders required it be done.

Exhibit 2

COMPLAINTS TO THE OFFICE OF THE OMBUDSMAN

DEPARTMENT: TREASURY

RE: PRINCIPAL GROUP INVESTIGATION

COMPLAINT	1987	1988	1989	TOTAL
1. Government action/inaction on:				
a) Licences.	8	8	2	18
b) Legislation.	11	1	0	12
c) Failure to advise contract holders.	33	2	0	35
d) Failure to act at an earlier date.	81	4	1	86
e) Failure to compensate.	2	1	3	6
f) Placing companies in receivership.	1	0	1	2
g) Collusion in collapse.	2	0	0	2
h) Public inquiry.	7	0	0	7
2. Alleged misrepresentations or action by investment companies.	33	4	6	43
3. Complaints against receivers.	9	1	0	10
4. General concerns.	11	2	3	16
TOTALS:	198	23	16	237

Exhibit
Page

PROVINCIAL TREASURER
224 Legislature Building, Edmonton, Alberta, Canada T5K 2B6 403/427-8809

October 6, 1987

RECEIVED
OCT 07 87
OFFICE OF THE OMBUDSMAN

Mr. Aleck Trawick
Ombudsman
Province of Alberta
1630 Phipps-McKinnon Building
10020 - 101A Avenue
EDMONTON, Alberta
T5J 3G2

Dear Mr. Trawick:

Now that you have assumed office, I would like to seek your assistance.

As you know, Mr. Code has been appointed by the Alberta Court of Queen's Bench to inquire into the financial collapse of the Principal Group of Companies. This Order was granted at the request of my Department.

It is our position that the Code Inquiry should have complete access to the Government files and that Ministers and other Government personnel will appear to testify.

We have full confidence that Mr. Code will carry out his mandate, however out of an abundance of caution I request that you review the Provincial regulatory process and administration of these regulations.

I understand that there may be good reasons for your not seeing any merit in duplicating some of the work being performed by Mr. Code. However, prior to issuing a ministerial order I would like your advice on how you feel you can most effectively proceed on this request.

As the Government's position on this matter has been open disclosure, I would like your further advice on whether we can properly request a waiver of the requirement that your investigation be in camera.

I look forward to hearing from you on this matter and I wish you success in your new responsibility as our Provincial Ombudsman.

Yours truly,

Dick Johnston
Provincial Treasurer

Exhibit 3
Page 2

PROVINCIAL TREASURER
224 Legislature Building, Edmonton, Alberta, Canada T5K 2B6 403/427-8809

October 14, 1987

Mr. Aleck Trawick
Ombudsman
Province of Alberta
1630 Phipps-McKinnon Building
10020 - 101A Avenue
Edmonton, Alberta
T5J 3G2

Dear Mr. Trawick:

Re: Principal Group of Companies

Due to the absence of the Honourable Dick Johnston, I am the Acting Provincial Treasurer.

Pursuant to Mr. Johnston's letter to you dated October 6, 1987, I would like you to consider this letter a Ministerial Order for your office to conduct the broadest possible review of the provincial regulatory process and administration of these Regulations.

In light of the on-going Code Inquiry, you may wish to coordinate your investigation with Mr. Code and, of course, you may wish to review additional matters beyond Mr. Code's investigation in order to conduct the broadest possible review, as requested above. We would like you to act on this Order and to contact me if we can assist in expediting this Order.

Yours truly,

James D. Horsman
Acting Provincial Treasurer

JDH/gw

Exhibit 3
Page 3

LEGISLATIVE ASSEMBLY
PROVINCE OF ALBERTA
Office of the Ombudsman

October 16, 1987

The Honourable Dick Johnston,
Provincial Treasurer,
224 Legislature Building,
EDMONTON, Alberta
T5K 2B6

DELIVERED BY HAND

Dear Mr. Johnston:

Re: Principal Group of Companies

Thank you for your letters of October 6 and 14, requesting me to investigate the Provincial regulatory process and the administration of those regulations as they relate to the collapse of the captioned group of companies.

You have requested in your letter my view as to the procedure to be used by my office in carrying out this investigation, specifically having regard to the Code Investigation.

It is my intention (for which there is precedent) to utilize for the purposes of my investigation the investigation conducted by Mr. Code, and thereafter to carry out what further investigation may be necessary to complete my mandate. You, of course, appreciate that under section 16 of the Ombudsman Act, my investigations mandatorily must be carried out in private, and, therefore, any further investigation of any particular matter or witness that I will carry out beyond the scope of the Code Investigation will be carried out in that fashion. Those further investigations will be carried out from time to time during the course of the Code Investigation and certainly thereafter. I would appreciate, to the extent that you are able to do so, a formal direction to Mr. Code to co-operate with me in my investigations. In making that request, however, I should point out that I have informally met with Mr. Code and his solicitor, and they have offered me every co-operation but it is my view that a formal request under these circumstances is appropriate.

I should point out that a number of investors who have complained to me have raised the point that they do not believe that the ambit of the Code Investigation can be made wide enough to include a full

1630 PHIPPS-McKINNON BUILDING, 10020 101 A AVENUE, EDMONTON, ALBERTA T5J 3G2 · (403) 427-2756

1080 McFARLANE TOWER, 700 4th AVENUE S.W., CALGARY, ALBERTA T2P 3J4 · (403) 297-6185

Exhibit 3
Page 4

investigation of Government involvement. I share that concern. In my discussions with Mr. Code and his counsel, and during a brief review of the documentation obtained to date, it seems clear that full and free disclosure is being made by Government officials to the Investigation, even including Cabinet documentation. Therefore, the information being reviewed by the Code Investigation will be of substantial help to me in my investigation. However, the Code Investigation, being conducted under the Business Corporations Act, may allow Mr. Code to review all of the relevant information, but may not allow him to make appropriate conclusions. I am somewhat concerned in that regard because of the rejection by Berger J. during the proceedings of an application for an order specifically requiring the Investigator to determine whether the Government of Alberta had carried out its obligations in respect of both the Corporations which are the subject of the Investigation and the security holders in those Corporations. Mr. Code may, of course, be limited by the Court as to the extent of his report.

It is my suggestion that you consider taking whatever steps are available to you to expand the ambit of the inquiry to clearly include the involvement of Government within the mandate of Mr. Code, so that a public determination might be made on the evidence that will be brought before the public during his Investigation.

I would also like to comment on the nature and use of any report or recommendation which may result from my investigation. As you are no doubt aware, I have received a considerable number of written complaints requesting me to investigate the involvement of Government in the captioned companies' demise. Those complaints relate to a variety of matters, but it is fair to say that on analysis of them, they would require me to investigate very fully the matters referred by you in your letters of October 6 and October 14. As you are further aware, I am required to investigate such complaints under section 11 (1) of the Ombudsman Act. I, therefore, intend to include your request, which is made pursuant to section 11 (5) of the Ombudsman Act, with those complaints but to report concerning the investigation as if it were an investigation pursuant to section 11 (1), as all of the written complaints to which I refer were received prior to your Order. Therefore, I will feel myself free to make recommendations and to take any necessary steps thereafter as set out in sections 20 and 21 of the Ombudsman Act. Because of the public interest in these matters, I also expect that my report will be made public under the provisions of section 27 of the Ombudsman Act.

Exhibit 3
Page 5

Because there has been substantial public question about the involvement of the Ombudsman in these matters, I have decided, as I discussed with representatives of your office, to make public your letters of October 6 and 14, and this letter, so there is no doubt that all avenues of investigation are being pursued.

Yours very truly,

Aleck Trawick
Ombudsman

AT/avm

Exhibit 3
Page 6

PROVINCIAL TREASURER
224 Legislature Building, Edmonton, Alberta, Canada T5K 2B6 403/427-8809

October 19, 1987

~~Mr. Neil C. Wittmann, Q.C.~~
~~#1700 Imperial Oil Tower~~
~~10025 Jasper Avenue~~
~~Edmonton, Alberta~~
~~T5J 1S6~~

Dear Mr. Wittman:

Re: Principal Group of Companies

Due to the absence of the Honourable Dick Johnston, I am the Acting Provincial Treasurer.

Mr. Aleck Trawick, the Provincial Ombudsman, has received a Ministerial Order, in accordance with the Ombudsman Act of Alberta ordering him to conduct an investigation of the provincial regulatory process and administration of those regulations with respect to the above noted.

The Government wishes to give Mr. Trawick every assistance in conducting his investigation.

It would be the desire of the Government that you provide Mr. Trawick with access to all documents, material and information requested by him as may be in your possession and this letter is intended, insofar as the Government of the Province of Alberta is concerned, as your authority to do so, in as much as such authority may be required.

It would also be the desire of the Government of the Province of Alberta that you co-operate with Mr. Trawick as needed, in every possible regard, in order to enable him to ensure that he is in a position to conduct the abovementioned full, complete and detailed investigation.

Should you require anything further, please contact me.

Yours truly,

James Horsman

James D. Horsman, Q.C.
Acting Provincial Treasurer

→ c.c. A. Trawick, Ombudsman

Exhibit 3
Page 7

LEGISLATIVE ASSEMBLY
PROVINCE OF ALBERTA
Office of the Ombudsman

PRESS RELEASE

Alberta Ombudsman, Aleck Trawick, has announced that he will investigate the involvement of the Provincial Government in the financial collapse of the Principal Group of Companies.

Mr. Trawick made it clear his investigation of the Government's role will be conducted on behalf of the Principal investors, a considerable number of whom have submitted written complaints to the Ombudsman and as a result of the request of Provincial Treasurer, Dick Johnston. After his investigation is complete, Mr. Trawick will make his findings available to all investors through a full public disclosure of the results.

In a letter to Mr. Johnston dated October 16, Mr. Trawick says he has met with William Code who is already heading an inquiry into the matter under the Business Corporations Act. The Ombudsman intends to participate in the Code Investigation and then investigate further as necessary to determine the involvement of the Provincial Government.

Mr. Trawick has made public Mr. Johnston's request of October 6, Mr. Horsman's order of October 14 and his own reply to Mr. Johnston of October 16 so that all Principal investors will be fully informed about the scope of the Ombudsman's investigation.

Aleck Trawick,
Ombudsman

October 20, 1987

1630 PHIPPS-McKINNON BUILDING, 10020 101 A AVENUE, EDMONTON, ALBERTA T5J 3G2 · (403) 427-2756

1080 McFARLANE TOWER, 700 4th AVENUE S.W., CALGARY, ALBERTA T2P 3J4 · (403) 297-6185

Exhibit 4
Page 1

A. Legislative History of the Promissory Note Exemption

Ontario:

1. The Security Frauds Prevention Act, 1928 S.O., c. 34.
2. The Securities Act, R.S.O. 1960, c. 363.
3. An Act to Amend the Securities Act, S.O. 1962-63, c. 131.
4. The Securities Act, S.O. 1966, c. 142, s. 19(2)(3).
5. An Act Regulating Deposits Solicited From the Public, S.O. 1962-63, c. 36.
6. The Securities Act, S.O. 1978, c.47.

Alberta:

7. The Sale of Shares Act, S.A. 1916, c.8.
8. The Security Frauds Prevention Act, 1929 S.A. 1929, c. 10.
9. The Securities Act, 1955 S.A. 1955, c.64.
10. An Act to Amend the Securities Act, S.A. 1964, c. 83.
11. The Securities Act, 1967 S.A. 1967, c. 76.
12. The Securities Act, S.A. 1981, c. 6.1.

B.C.:

13. The Securities Act, S.B.C. 1985, c. 83.

Exhibit 4

B. Investment Contracts Act, Legislative History

1. The Investment Contracts Act, S.A. 1957, c. 36.
2. An Act to Amend The Investment Contracts Act, S.A. 1960, c. 51.
3. An Act to Amend The Investment Contracts Act, S.A. 1962, c. 37.
4. An Act to Amend The Investment Contracts Act, S.A. 1963, c. 27.
5. An Act to Amend The Investment Contracts Act, S.A. 1966, c. 43.
6. Reproduced by R.S.A. 1970, c. 191.
7. The Investment Contracts Amendment Act, 1972 S.A. 1972, c. 56.
8. The Department of Consumer Affairs Act, S.A. 1973, c. 22 (consequential amendments).
9. The Investment Contracts Amendment Act, 1973 S.A. 1973, c. 32.
10. The Department of Consumer Affairs Act, S.A. 1975, c.9 (consequential amendments).
11. The Court of Appeal Act, S.A. 1978, c. 50 (consequential amendments).
12. The Court of Queen's Bench Act, S.A. 1978, c. 51 (consequential amendments).
13. Reproduced by R.S.A. 1980, c. 1-10.
14. The Business Corporations Act, S.A. 1981, c. B-15 (consequential amendments).

Exhibit 4
Page 3

C. MISCELLANEOUS

1. Laws of Hong Kong - Deposit-taking Companies Ordinance, C. 328, Revised Edition 1983.
2. The Trust Companies Act, S.C. T-16, 1964-65, C. 40, S. 34.
3. The Proceedings Against the Crown Act, R.S.A. 1980, C. P-18.
4. Hong Kong Ordinance 18, Rule 19.
5. Securities Act Regulations, Alberta Regulation 15/82.
6. Securities Act Regulations, Alberta Regulation 90/87.
7. Securities Act Regulations, British Columbia Regulation 270/86.
8. Securities Act Regulations, Ontario Regulation 910/80, as amended.
9. Alberta Securities Commission Policy 5.1.
10. Alberta Securities Commission Notice 13.

Exhibit 4
Page 4

D. AUTHORITIES

1. Alboini, Victor P. Securities Law and Practice, Carswell, at pg. 11 - 31.

2. Johnston, David L., Canadian Securities Regulations Butterworths, Toronto, at pg. 1.

3. Report of the Attorney General's Committee on Securities Legislation in Ontario, March, 1965 (the "Kimber Report"), at pg. 9.

4. Special Lectures - 1972, Law Society of Upper Canada, "Exemption Under the Securities Act of Ontario", Dey, Peter J., at pg. 130.

5. Studies in Canadian Company Law, Ziegel, Jacob S. editor, "Recent Developments in Securities Administration in Ontario: The Securities Act, 1966", Bray, Harry S. at pg. 422.

6. Williamson, Peter J., Securities Regulation in Canada, University of Toronto Press, 1960, at pg. 132.

7. Canadian Business Law Journal [Vol. 12 1986-87] 45, Slow Courier in the Supreme Court: A Comment on B.D.C. Ltd. v. Hofstrand Farms Ltd.

E. TABLE OF CASES

1. Anns v. Merton London Borough Council (H.L.(E.)) [1978] A.C. p. 728.

2. Report of cases - Kamloops v. Nielsen, Hughes and Hughes [S.C.C.] [1984] 5 W.W.R. 1.

3. Yuen Kun Yeu v. Attorney General of Hong Kong [1987] 3 W.L.R. 776.

4. Baird et al v. The Queen in Right of Canada (1983) 1-148 D.L.R. (3d) F.C.A.

5. Home Office v. Dorset Yacht Co. Ltd. [1970] A.C. 1004, [1970] 2 W.L.R. 1140, [1970] 2 All. E.R. 294.

6. Governors of the Peabody Donation Fund v. Sir Lindsay Parkinson & Co. Ltd. [1985] A.C. 210.

7. The Council of the Shire of Sutherland v. Heyman (1985) 59, A.L.J.R. 564.

8. Curran v. Northern Ireland Ownership Housing Association Ltd. [1987] 2 W.L.R. 1043-1049.

9. Birchard et al v Alberta Securities Commission et al (1987) 54 A.L.R. (2d) 302.

10. Kyoouot Logging Ltd. v. British Columbia Forest Projects and Her Majesty the Queen in Right of the Province of British Columbia et al (an unreported decision of Justice McEachern of the British Columbia Court of Queen's Bench dated September 18, 1986).

11. Rothfield v. Manotakos [1987] 20 B.C.L.R. (2d), Carrothers J.A., 85.

12. Rowling v. Takaro Properties Ltd. [1988] 1 All.E.R. PC, 163.

13. Rivtow Marine Ltd. v. Washington Iron Works et al (1973) 40 D.L.R. (3d) 530, [1974] S.C.R. 1189, [1973] 6 W.W.R. 692.

14. B.D.C. Ltd. v. Hofstrand Farms Limited and R. in Right of British Columbia [1986] 3 W.W.R. 216.

15. Candlewood Navigation Corporation Ltd. v. Mitsui O.S.K. Lines Ltd. et al (1985) 1 A.C. 1986-1.

16. Leigh and Sillvan Ltd. v. Aliakmon Shipping Co. Ltd. (1986) 1 A.C. 1986-33, 785.

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17. *Hill* v. *Chief Constable of West Yorkshire*, [1988] 2 All. E.R. 238.

18. *Smith et al* v. *Littlewoods Organization Ltd. et al* [1987] 1 All. E.R. 711.

19. *Rondel* v. *Worsley* [1969] 1 A.C. 191.

20. *Welbridge Holdings Ltd.* v. *The Metropolitan Corporation of Greater Winnipeg* [1971] S.C.R. 957.

21. *Kresic* v. *Alberta Securities Commission* (1985) 37 Alta. L.R. (2d) 342.

22. *Thorne Riddel Inc.* v. *R. In Right of Alberta* (1983), 28 Alta. L.R. (2d) 326.

23. *Dorsch et al* v. *City of Weyburn* (1985), 23 D.L.R. (4th) 379.

24. *McGauley* v. *Minister of Finance and Corporate Relations et al* (1988) 23 B.C.L.R. (2d) 137.

25. *MacAlpine* v. *Hardy et al* (an unreported decision of Justice Millward of the British Columbia Supreme Court dated November 18, 1988.

26. *Doe* v. *Metropolitan Toronto (Municipality) Commissioners of Police)* (an unreported decision of Justice Henry, Ontario High Court of Justice dated March 31, 1989).

27. *Roncarelli* v. *Duplessis* [1959] S.C.R. 121.

Exhibit 5

THE PRINCIPAL GROUP CORPORATE CHART AS AT JUNE 30, 1987 (2)

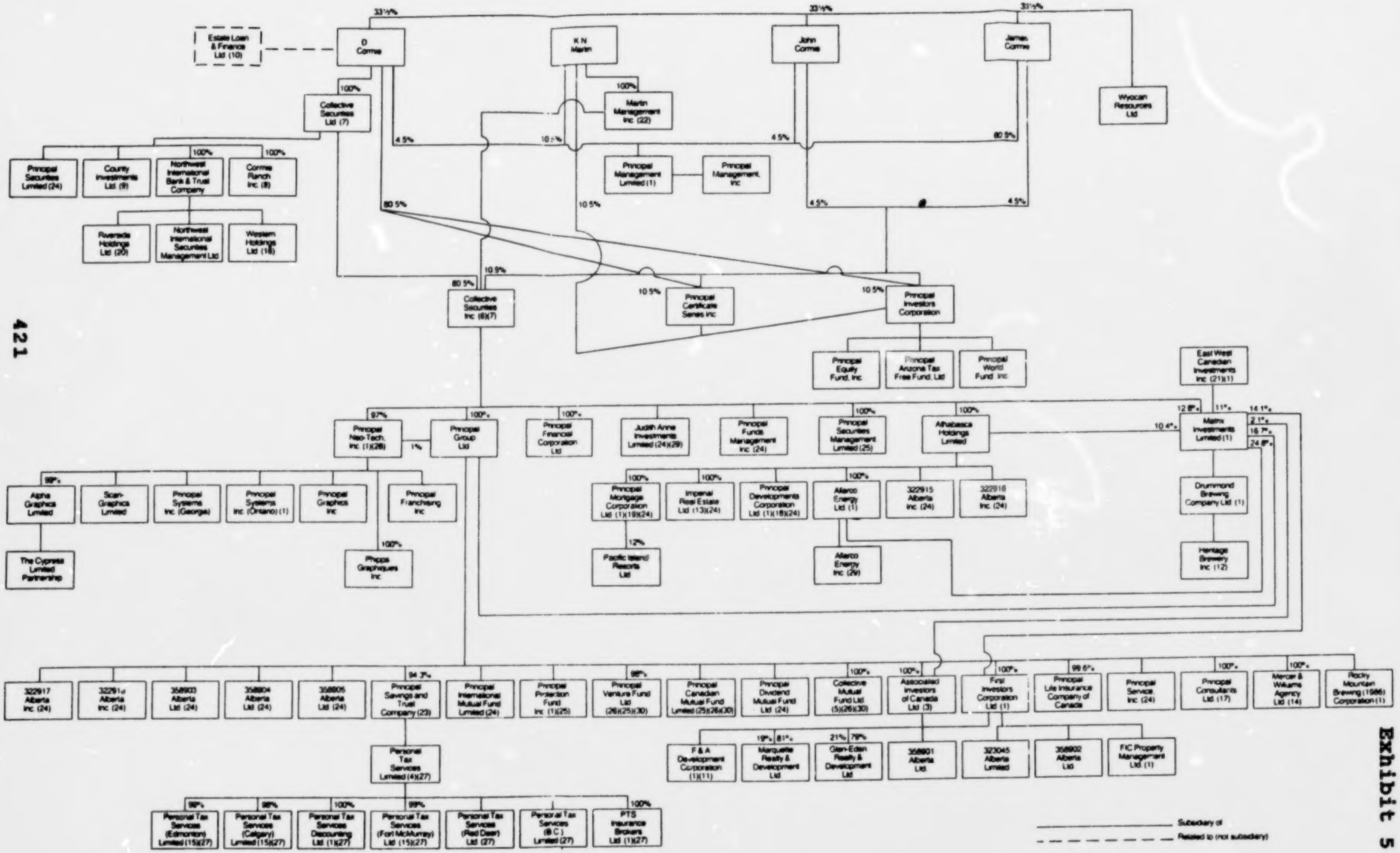
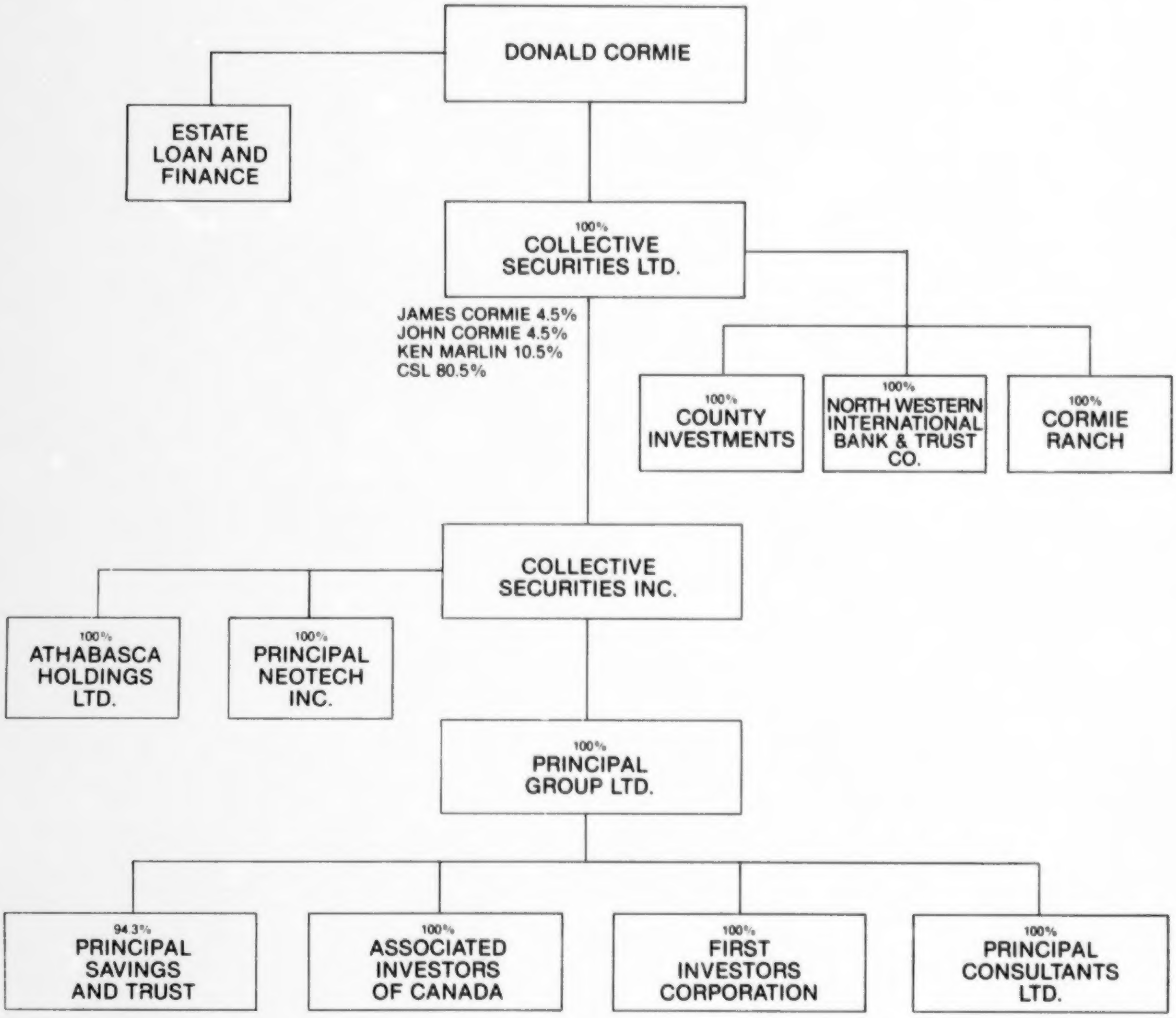

33⅓%
33⅓%
33⅓%
Estate Loan & Finance Ltd (10)
D Cormie
K N Martin
John Cormie
James Cormie
Wyocan Resources Ltd
100%
Collective Securities Ltd (7)
100%
Martin Management Inc (22)
4.5%
10½%
4.5%
80.5%
Principal Management Limited (1)
Principal Management, Inc
100%
100%
Principal Securities Limited (24)
County Investments Ltd (9)
Northwest International Bank & Trust Company
Cormie Ranch Inc (8)
Riverside Holdings Ltd (20)
Northwest International Securities Management Ltd
Western Holdings Ltd (18)
80.5%
10.5%
4.5%
4.5%
10.9%
80.5%
10.5%
10.5%
Collective Securities Inc (6)(7)
Principal Certificate Series Inc
Principal Investors Corporation
Principal Equity Fund, Inc
Principal Arizona Tax Free Fund, Ltd
Principal World Fund Inc
East West Canadian Investments Inc (21)(1)
97%
100%
100%
100%
100%
12.8%
11%
14.1%
10.4%
2.1%
16.7%
24.8%
Principal Neo-Tech, Inc (1)(28)
1%
Principal Group Ltd
Principal Financial Corporation Ltd
Judith Anne Investments Limited (24)(28)
Principal Funds Management Inc (24)
Principal Securities Management Limited (25)
Athabasca Holdings Limited
Matrix Investments Limited (1)
99%
Alpha Graphics Limited
Scan-Graphics Limited
Principal Systems Inc (Georgia)
Principal Systems Inc (Ontario) (1)
Principal Graphics Inc
Principal Franchising Inc
The Cypress Limited Partnership
100%
Phipps Graphiques Inc
100%
100%
100%
Principal Mortgage Corporation Ltd (1)(19)(24)
Imperial Real Estate Ltd (13)(24)
Principal Developments Corporation Ltd (1)(18)(24)
Allarco Energy Ltd (1)
322915 Alberta Inc (24)
322916 Alberta Inc (24)
12%
Pacific Island Resorts Ltd
Allarco Energy Inc (29)
Drummond Brewing Company Ltd (1)
Heritage Brewery Inc (12)
94.3%
98%
100%
100%
100%
99.6%
100%
100%
322917 Alberta Inc (24)
322914 Alberta Inc (24)
358803 Alberta Ltd (24)
358804 Alberta Ltd (24)
358805 Alberta Ltd (24)
Principal Savings and Trust Company (23)
Principal International Mutual Fund Limited (24)
Principal Protection Fund Inc (1)(25)
Principal Venture Fund Ltd (26)(25)(30)
Principal Canadian Mutual Fund Limited (25)(26)(30)
Principal Dividend Mutual Fund Ltd (24)
Collective Mutual Fund Ltd (5)(26)(30)
Associated Investors of Canada Ltd (3)
First Investors Corporation Ltd (1)
Principal Life Insurance Company of Canada
Principal Service Inc (24)
Principal Consultants Ltd (17)
Mercer & Williams Agency Ltd (14)
Rocky Mountain Brewing (1986) Corporation (1)
Personal Tax Services Limited (4)(27)
19%
81%
21%
79%
F & A Development Corporation (1)(11)
Marquette Realty & Development Ltd
Glen-Eden Realty & Development Ltd
358801 Alberta Ltd
323045 Alberta Limited
358802 Alberta Ltd
FIC Property Management Ltd (1)
98%
98%
100%
99%
100%
Personal Tax Services (Edmonton) Limited (15)(27)
Personal Tax Services (Calgary) Limited (15)(27)
Personal Tax Services Discounting Ltd (1)(27)
Personal Tax Services (Fort McMurray) Ltd (15)(27)
Personal Tax Services (Red Deer) Ltd (27)
Personal Tax Services (B C) Limited (27)
PTS Insurance Brokers Ltd (1)(27)
Subsidiary of
Related to (not subsidiary)

Exhibit 6

PRINCIPAL GROUP OF COMPANIES REFERRED TO IN THE OMBUDSMAN'S REPORT


DONALD CORMIE
ESTATE LOAN AND FINANCE
100%
COLLECTIVE SECURITIES LTD.
JAMES CORMIE 4.5%
JOHN CORMIE 4.5%
KEN MARLIN 10.5%
CSL 80.5%
100%
COUNTY INVESTMENTS
100%
NORTH WESTERN INTERNATIONAL BANK & TRUST CO.
100%
CORMIE RANCH
COLLECTIVE SECURITIES INC.
100%
ATHABASCA HOLDINGS LTD.
100%
PRINCIPAL NEOTECH INC.
100%
PRINCIPAL GROUP LTD.
94.3%
PRINCIPAL SAVINGS AND TRUST
100%
ASSOCIATED INVESTORS OF CANADA
100%
FIRST INVESTORS CORPORATION
100%
PRINCIPAL CONSULTANTS LTD.

Associated Investors of Canada Ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER
IF NOT COMPLETED ATTACH
A COMPLETED SIGNATURE CARD ______

TMS-CC- 37001

FOR OFFICE USE ONLY | LINE NO | PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER

SOCIAL INSURANCE NUMBER ___ / ___ / ___

☐ IN TRUST FOR (NOT PERMITTED ON RRSP'S) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

● FIC – FIRST INVESTORS CORPORATION LTD
AIC – ASSOCIATED INVESTORS OF CANADA LTD
●● D – DAYS
Y – YEARS
●●● M – MONTHLY
A – ANNUALLY
T – AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE ☐ 4.000 %

	SERIES	● ISSUER FIC AIC	●● TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	●●● PAY INTEREST M A T	
1.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______
2.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______
3.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______
4.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______
5.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND

B FIXED INTEREST TERM CERTIFICATES

	SERIES	● ISSUER FIC AIC	●● TERM	FIXED INTEREST RATE	●●● PAY INTEREST M A T	
6.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______
7.	☐☐☐	☐☐	☐☐	☐☐.☐☐ %	☐☐☐	$ ______

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M Q SA A
8.	☐☐☐	☐☐	☐☐	☐ 4.000 %	☐☐☐☐

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM ☐☐.☐☐ % $ ______

RETIREMENT SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $ ______
☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 FOR EACH PLAN) $ ______
☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $ ______

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT
______
______

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID FOR THE CURRENT QUARTER. ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON A QUARTERLY BASIS

INITIAL ☐ FIXED INTEREST RATE ☐ 4.000 %

	SERIES	● ISSUER FIC AIC	●● TERM	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$ ______
10	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$ ______
11	☐☐R	☐☐	☐☐	☐☐.☐☐ %	$ ______

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	● ISSUER FIC AIC	●● TERM	FIXED INTEREST RATE		
12	☐☐R	☐☐	☐☐	☐☐☐☐ %	INTEREST COMPOUNDED ANNUALLY TO MATURITY	$ ______
13	☐☐R	☐☐	☐☐	☐☐☐☐ %		$ ______

TOTAL MONEY SERVICES OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND ASK YOU TO OPEN A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT AND ISSUE A PRINCIPAL CASH MANAGEMENT CARD. I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD. I AGREE TO PAY ALL CHARGES ON THE ACCOUNT

☐ I HAVE OR HAVE APPLIED FOR A PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT. PLEASE PAY ALL APPLICABLE PROCEEDS FROM THE ABOVE NON RRSP PLAN(S) INTO THIS DAILY INTEREST SAVINGS ACCOUNT

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ YES, I do wish to designate a beneficiary for the above plan(s)
(Complete beneficiary election on reverse side of this application)

☐ NO, I do not wish to designate a beneficiary for the above plan(s)

EXTENDED TERM OPTION

On RRSP term certificates with an original term of less than one year the extended term option as described on the reverse side of this application is automatically applied.

For all other types of term certificates complete the following:

☐ YES, I do wish to renew the above term certificate(s)
(See reverse side of this application for Extended Term Option terms and conditions)

☐ NO, I do not wish to extend the term of the above term certificate(s) at this time

SPECIAL INSTRUCTIONS
______
______

WHOM DO YOU KNOW?

Who, among your acquaintances would benefit from hearing about Principal's services?

NAME ADDRESS PHONE OCCUP
1 ______
2 ______
3 ______

SATISFIED AS FOLLOWS
______ CHEQUE $ ______
______ MONEY ORDER $ ______
______ CASH (RECEIPT NO.) $ ______

PROCEEDS FROM CERTIFICATE NO.
______ ☐ EST ☐ ACT $ ______
______ ☐ EST ☐ ACT $ ______
______ ☐ EST ☐ ACT $ ______

I DIRECT THAT THE PROCEEDS FROM THE ABOVE [illegible] CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST ACCOUNT [illegible] SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR ANY [illegible] FOR THE PLAN APPLIED FOR ABOVE

TOTAL $ ______

ACKNOWLEDGMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE TERMS OF THE CONTRACT ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID INTO EITHER MY PRINCIPAL TOTAL MONEY SERVICES SAVINGS ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR OR INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON AN ATTACHED SIGNATURE CARD AS THE CASE MAY BE. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED

SIGNED AT ______ IN THE PROVINCE OF ______

THIS ______ DAY OF ______ 19 ______

______
APPLICANT'S SIGNATURE

______
CONSULTANT'S SIGNATURE

______
JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME	INITIALS	%
1				
2				
3				

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION

Form 800 (Rev 2/84)

COMPANY COPY

SIGNATURE CARD TMS-CC- 37001

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For ______
☐ Savings ☐ Joint (All must sign) ☐ Other ______

ACCOUNT NUMBER

Name M ______
First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ______
______ Postal Code

Joint or In Trust For M ______
First Middle Last

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address ______
______ Postal Code

Res. Phone ______ Bus. Phone ______

Identification: Type ______ No ______
Type ______ No ______

______ Account Owner Occupation
______ Name of Employer
______ Address of Employer

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ___/___/___ Day Mo Year

Signature(s) ______
______

Consultant ______ Name ______ No

Exhibit 7
Page 2

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES

☐ First Investors Corporation Ltd and Associated Investors of Canada Ltd are registered under the Investment Contracts Act (Alberta) Assets equal to 100% of certificate liabilities are maintained on deposit with a Canadian chartered bank Assets are in qualified investments of the type permitted to Canadian incorporated life insurance companies **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION**

TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate In the event that the company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify you of such occurrence forthwith
Upon each renewal hereunder a new term certificate shall be issued This said application shall constitute the application for all new term certificates issued under this said extended term option

☐ The commencement date for the plan(s) applied for shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre by 3 00 p m provided this application is correctly completed Applications and payments received after 3 00 p m will be dated the subsequent business day

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE (Section C)

☐ This certificate is non-cashable non-transferable and non-assignable

RETIREMENT SAVINGS PLANS (Sections D & E)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada)

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable any Provincial Income Tax Act income tax may be payable on any benefit paid out under a Retirement Plan

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71 The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act

☐ I understand that in accordance with Section 146 of the Income Tax Act the Plan(s) will be registered in my name

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E ☐ SPA-V Plan (Section C)

I ______________________ hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death the person set out hereunder if living at my death otherwise my estate

NAME OF BENEFICIARY ______________________

RELATIONSHIP ______________________

____

(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER) ______________________

PRESENT ADDRESS ______________________

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd If any portion of the payment is returned for any reason the entire application will be null and void

Consultant (Witness) ______________________

Applicant ______________________

Date ______________________

Joint Applicant ______________________

Sign White Copy Only

REGULATIONS

1 Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor s(s) Savings Account(s) to cover any overdraft that may occur from time to time
2 When deposits are made in the form of cheques, drafts, etc the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received
3 Interest will be allowed at such rate and on such terms as the Company shall from time to time establish
4 The Company reserves the right to require thirty days notice of any withdrawal
5 In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay
6 Every statement of an account of the depositor(s) which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement
7 In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them
8 For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not affect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest

Exhibit 8
Page 1

Associated Investors of Canada ltd.
First Investors Corporation Ltd.

ACCOUNT NUMBER (NEW ACCOUNTS MUST COMPLETE ATTACHED SIGNATURE CARD)

FOR OFFICE USE ONLY — LINE NO — PLAN NO

APPLICANT	GIVEN NAME	INITIAL	LAST NAME (OR COMPANY)
MR MRS MISS MS			

☐ JOINT APPLICANT (NOT PERMITTED ON RETIREMENT SAVINGS PLANS) WITH RIGHT OF SURVIVORSHIP BOTH APPLICANTS MUST SIGN PROVIDE NAME BELOW

☐ SPOUSAL CONTRIBUTOR PROVIDE NAME AND SOCIAL INSURANCE NUMBER

SOCIAL INSURANCE NUMBER

☐ IN TRUST FOR (NOT PERMITTED ON RRSP's) PROVIDE NAME BELOW

APPLICANT	GIVEN NAME	INITIAL	LAST NAME
MR MRS MISS MS			

NON-REGISTERED PLANS

●FIC — FIRST INVESTORS CORPORATION LTD
AIC — ASSOCIATED INVESTORS OF CANADA LTD
●●D — DAYS
Y — YEARS
●●●M — MONTHLY
A — ANNUALLY
T — AT MATURITY

A ADDITIONAL CREDIT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	●ISSUER FIC AIC	●● TERM	PLUS CURRENT ADDITIONAL CREDITS PER ANNUM	●●● PAY INTEREST M A T	
1.				. %		$
2.				. %		$
3.				. %		$
4.				. %		$
5.				. %		$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

B FIXED INTEREST TERM CERTIFICATES

	SERIES	●ISSUER FIC AIC	●● TERM	FIXED INTEREST RATE	●●● PAY INTEREST M A T	
6.				. %		$
7.				. %		$

C PRINCIPAL RETIREMENT ANNUITY CERTIFICATES (SPA V)

	SERIES	FIC AIC	TERM YEARS	FIXED INTEREST RATE	PAY M S SA A	
8.				4.000 %		

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE PAID ON THE FIRST ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE DIRECTORS OF THE COMPANY ON AN ANNUAL BASIS

INITIAL ☐ PLUS CURRENT ADDITIONAL CREDITS PER ANNUM . % $

OTHER OPTIONS

☐ I HEREBY APPLY FOR THE BENEFITS OF PRINCIPAL'S TOTAL MONEY SERVICES AND I AGREE TO PAY ALL FEES FOR THIS SERVICE

☐ I HEREBY APPLY FOR A FREE PRINCIPAL CASH MANAGEMENT CARD AND I AGREE TO BE BOUND BY THE AGREEMENT(S) RECEIVED WITH THE CARD

☐ I HEREBY APPLY FOR A PRINCIPAL PLATINUM PLUS ACCOUNT

SPECIAL INSTRUCTIONS

EXTENDED TERM OPTION

☐ **YES.** I do wish to renew the above term deposit(s).
(See reverse side of this application for Extending Term Option terms and conditions.)

☐ **NO.** I do not wish to extend the term of the above term deposit(s) at this time.

ACKNOWLEDGEMENT

I HEREBY APPLY FOR THE PLAN(S) ABOVE. I HAVE REVIEWED AND AGREE TO ALL THE TERMS AND CONDITIONS OF THE APPLICABLE "TERMS OF THE CONTRACT" ON THE REVERSE SIDE OF THIS APPLICATION. ALL APPLICABLE PROCEEDS ARE TO BE PAID TO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR HEREBY APPLIED FOR ON THE ATTACHED SIGNATURE CARD. IF THIS APPLICATION IS REJECTED MY MONIES WILL BE PROMPTLY RETURNED.

REGISTERED SAVINGS PLANS

BIRTHDATE AND SOCIAL INSURANCE NUMBER ARE MANDATORY ON REGISTERED PLANS

☐ REGISTRATION OF NEW FUNDS $

☐ TRANSFER FROM RRSP (MUST BE ACCOMPANIED WITH FORM T2033 OR FORM 946 FOR EACH PLAN) $

☐ DIRECT TRANSFER FROM REGISTERED PENSION PLAN (MUST BE ACCOMPANIED BY FORM TD2) $

ADDRESS OF SPOUSAL CONTRIBUTOR IF DIFFERENT FROM APPLICANT

D ADDITIONAL CREDIT RETIREMENT TERM CERTIFICATES

THE ADDITIONAL CREDIT RATE SHOWN HAS BEEN DECLARED AND WILL BE CREDITED ON THE CERTIFICATE'S QUARTERLY ANNIVERSARY ADDITIONAL CREDITS ARE DECLARED AT THE DISCRETION OF THE BOARD OF DIRECTORS AT THE END OF EACH CALENDAR QUARTER

INITIAL ☐ FIXED INTEREST RATE 4.000 %

	SERIES	●ISSUER FIC AIC	TERM YEARS	PLUS CURRENT ADDITIONAL CREDIT PER ANNUM	
9	R			. %	$
10	R			. %	$
11	R			. %	$

THE FIXED INTEREST RATE AND ADDITIONAL CREDITS COMPOUND ANNUALLY TO MATURITY

E FIXED INTEREST RETIREMENT TERM CERTIFICATES

	SERIES	●ISSUER FIC AIC	TERM YEARS	FIXED INTEREST RATE		
12	R			. %	INTEREST COMPOUNDS ANNUALLY TO MATURITY	$
13	R			. %		$

BENEFICIARY ELECTION (RRSP OR SPA V)

☐ **YES.** I do wish to designate a beneficiary for the above plan(s).
(Complete beneficiary election on reverse side of this application.)

☐ **NO.** I do not wish to designate a beneficiary for the above plan(s).

SATISFIED AS FOLLOWS
_______ CHEQUE $
_______ MONEY ORDER $
_______ CASH (RECEIPT NO.) $

PROCEEDS FROM CERTIFICATE NO
☐ EST ☐ ACT $
☐ EST ☐ ACT $
☐ EST ☐ ACT $

I DIRECT THAT THE PROCEEDS FROM THE ABOVE (NON RRSP) CERTIFICATE(S) BE PAID INTO MY PRINCIPAL TRUST CHEQUING ACCOUNT NUMBER SHOWN ABOVE OR APPLIED FOR AND THAT MY ACCOUNT BE DEBITED FOR PAYMENT FOR THE PLAN APPLIED FOR ABOVE

TOTAL $

SIGNED AT _______ IN THE PROVINCE OF _______

THIS _______ DAY OF _______ 19 _______

APPLICANT'S SIGNATURE

CONSULTANT'S SIGNATURE

JOINT APPLICANT'S SIGNATURE

	NO	CONSULTANT'S SURNAME
1		
2		
3		

INITIALS

%

CERTIFICATES OFFERED ON THIS APPLICATION ARE NOT COVERED BY THE PROVISIONS OF THE CANADA DEPOSIT INSURANCE CORPORATION

Form 580 Rev. 10/84

COMPANY COPY

SIGNATURE CARD

Type of Account
☐ Chequing ☐ Joint (Either to sign) ☐ In Trust For _______ ☐ TMS
☐ Savings ☐ Joint (All must sign) ☐ Other _______ ☐ PPL
A monthly fee will be charged for TMS service

ACCOUNT NUMBER

Name M _______ First _______ Middle _______ Last _______

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address _______ Postal Code

Joint or In Trust For M _______ First _______ Middle _______ Last _______

Date of Birth ___/___/___ Day Mo Year ___/___/___ Social Insurance Number

Address _______ Postal Code

Res. Phone _______ Bus. Phone _______

Identification Type _______ No _______
Type _______ No _______

Account Owner Occupation _______ Name of Employer _______

Address of Employer _______

I/We the depositor(s) agree to abide by the regulations stated on this card. (See reverse side.) Date ___/___/___ Day Mo Year

Signature(s) _______

Consultant _______ Name _______ No

Exhibit 8
Page 2

TERMS OF THE CONTRACT

CHECK THE APPROPRIATE BOXES AND EXPLAIN EACH FEATURE

☐ I understand that First Investors Corporation Ltd and Associated Investors of Canada Ltd are registered under the Investment Contracts Act (Alberta). Pursuant to the Investment Contracts Act, the company is required to maintain assets equal to its liabilities to the holders of its contracts on deposit with a Canadian chartered bank. **THESE CERTIFICATES ARE NOT COVERED BY THE CANADA DEPOSIT INSURANCE CORPORATION.**

☐ The commencement date shall be the date the application and funds are received by a Savings Officer at the nearest designated Principal Financial Centre, provided they are received prior to 3:00 p.m. The commencement date for all application and payments received after 3:00 p.m. shall be the next business day.

TERM CERTIFICATES (Sections A, B, D & E)

☐ Term certificates are non-cashable and non-transferable prior to maturity

☐ Non RRSP term certificates may be assigned only with the consent of the Company and with payment of a fee based on the currently issued schedule

☐ No interest will be paid on term certificates after maturity unless the extended term option below has been elected prior to maturity

☐ On RRSP term certificates with an original term of less than one year the extended term option below is automatically applied

EXTENDED TERM OPTION (Sections A, B, D & E)

☐ I wish to renew the certificate(s) applied for on the reverse side hereof, upon maturity for terms each identical in length to the original term and all subsequent renewal terms and I declare that I shall have the right to revoke this direction by notice in writing at any time and that such revocation is to be effective at the maturity of the term then in effect at the time of revocation. Interest during a renewal of any term shall be calculated and credited in the exact manner of this certificate at an interest rate plus additional credit rate equivalent to the rates then offered by the Company at the time of renewal on certificates having the exact provisions and terms as this certificate. In the event that the Company does not offer at the time of renewal a certificate having the exact provisions and terms as this certificate the renewal so elected shall be void and the Company shall notify me of such occurrence forthwith. Upon each renewal hereunder a new term certificate shall be issued. This said application shall constitute the application for all new certificates issued under this said extended term option

PRINCIPAL RETIREMENT ANNUITY CERTIFICATE
(Section C)

☐ This certificate is non-cashable, non-transferable and non-assignable

RETIREMENT SAVINGS PLANS (Sections D & E)
(Explain Each Feature)

☐ This application form together with the certificate containing the privileges, terms and conditions constitutes a contract pursuant to paragraph 146(1)(j) of the Income Tax Act

☐ I hereby request that my application be submitted for registration as a REGISTERED RETIREMENT SAVINGS PLAN under Section 146 of the Income Tax Act

☐ I understand that the amount paid into the plan may be deducted for Income Tax purposes up to the amount allowable under Section 146 of the Income Tax Act

☐ I understand that all monies paid into the plan and all profits and or interest thereon are non-assignable, non-transferable and non-withdrawable except as provided by the Income Tax Act (Canada)

☐ I understand that in accordance with the Income Tax Act (Canada) or if applicable any Provincial Income Tax Act income tax may be payable on any benefit paid out under a Retirement Plan

☐ I understand that I may elect a maturity date at any time after attaining age 60 and prior to 180 days of attaining age 71. The Income Tax Act does not allow the maturity date to be elected beyond the last day of the year in which I attain age 71

☐ The retirement value at the elected maturity date will be paid to me in the form of an annuity as required under Section 146 of the Income Tax Act

☐ I understand that in accordance with Section 146 of the Income Tax Act the Plan(s) will be registered in my name

BENEFICIARY ELECTION
(Allowed only if the Plan is a RRSP or SPA-V)

☐ RRSP Plan(s) Sections D & E ☐ SPA-V Plan (Section C)

I ____________________ hereby revoke any previous designation of beneficiary made by me under the provisions of the Plan(s) hereby applied for on the reverse side of this application and pursuant to the provisions of the said Plan(s) do hereby designate as my beneficiary and the person entitled to receive my interest in the said Plan(s) on my death the person set out hereunder if living at my death, otherwise my estate

NAME OF BENEFICIARY	RELATIONSHIP
	(SOCIAL INSURANCE NUMBER IF NOT RELATED TO PLANHOLDER)
PRESENT ADDRESS	

ACKNOWLEDGEMENT

I acknowledge that the above terms including the beneficiary election have been fully reviewed with me by the consultant and the check marks above indicate that I fully understand the explanation

I acknowledge that all payments are to be made payable to PRINCIPAL PLANS and to be submitted to Principal Consultants Ltd. If any portion of the payment is returned for any reason the entire application will be null and void

Consultant (Witness)____________________ Applicant ____________________

Date____________________ Joint Applicant ____________________

Sign White Copy Only

REGULATIONS

1. Principal Savings and Trust Company (hereinafter called the Company) will transfer funds from the depositor's(s) Savings Accounts(s) to cover any overdraft that may occur from time to time
2. When deposits are made in the form of cheques, drafts, etc., the Company reserves the right to refuse withdrawal of such funds until advice of payment has been received
3. Interest will be allowed at such rate and on such terms as the Company shall from time to time establish
4. The Company reserves the right to require thirty days notice of any withdrawal
5. In consideration of the Company keeping in its books an account of the type indicated on the reverse side opened by the depositor, it is hereby expressly agreed between the depositor(s) and the Company that the latter may from time to time make and debit to said account its usual charges for the keeping of an account, which charges the depositor(s) hereby agree(s) to pay
6. Every statement of an account of the depositor(s), which the Company may from time to time mail addressed to the depositor(s) at the Post Office address last known to the Company shall be conclusive evidence that the balance shown hereby is correct and be binding on the depositor(s), except as to any payment made on a forged or unauthorized endorsement and any error or omission notified in writing by the depositor(s) to the Company within thirty days after the mailing of the statement
7. In order effectually to constitute this account, each of the depositors hereby assigns and transfers to all the depositors jointly and to the survivor or survivors of them all money heretofore or hereafter credited to said account and all interest thereon to be the joint property of the depositor(s), and the property of survivor or survivors of them
8. For valuable consideration received, the depositors hereby agree jointly and each with the other(s) of them and also with the Company that all monies heretofore or hereafter credited to said account and all interest thereon shall be and continue to be the joint property of the depositors with right of survivorship, and that the Company may accept as a sufficient discharge for any sums withdrawn from said account any order of receipt signed by any one or more of the depositors without any signature or consent of the other(s), and that the death of one of the depositors shall not effect the right of the survivors or any one of them or the sole survivor to withdraw said monies and interest and to give a valid discharge therefore, subject, however, to the requirements of any Succession Duty Act in respect of such monies and interest